

THE INDONESIAN QUARTERLY

Focus on the Pacific

- Current Events
- Southeast Asia in the Wider Pacific:
Issues of Cooperation
- The Role of PECC in the 1990s and
Pacific Institutions
- Japan's Role in the Asia-Pacific Region:
An ASEAN Perception
- Japan, the USSR, and the PRC:
Triangular Relationship in the Making
- The Major Powers and Regional Issues
in Southeast Asia
- Pacific Island Economies: Structure and
Current Developments
- Book Reviews



The Quarterly

The Indonesian Quarterly is a journal of policy oriented studies published by the Centre for Strategic and International Studies (CSIS), Jalan Tanah Abang III/23-27, Jakarta 10160. It is a medium for research findings, evaluations and views of scholars, statesmen and thinkers on the Indonesian situation and its problems. It is also a medium for Indonesian views on regional and global problems. The opinions expressed in *The Indonesian Quarterly* are those of their authors and do not necessarily reflect the opinion of the CSIS.

The Logo



To better represent the underlying ideas that gave birth to the CSIS in 1971 the Centre uses as of 1989 the logo that figures on the front cover of this journal. The original, in bronze, designed by G. Sidhartha, it consists of a disc with an engraving that depicts the globe which serves as a background to a naked man with an open book laid on a cloth over his lap, his left hand pointing into the book, his right hand raised upwards. Altogether it symbolises the Centre's nature as an institution where people think, learn and communicate their knowledge to whoever are interested, to share it with them, mankind the world over being their concern and the globe their horizon. The nakedness symbolises the open-mindedness, the absence of prejudice, in the attitude of the scholars who work with the Centre, just as it is with scholars everywhere. The inscription reads "*Nalar Ajar Terusan Budi*," which in the Javanese language essentially means that to think and to share knowledge are only the natural consequence of an enlightened mind. It is a *surya sengkala*, that is *chandra sengkala*, a Javanese traditional way to symbolise a commemorable year in the lunar calendar, adapted to the solar calendar system. It consists in using words that express the perceived meaning of the commemorated year while marking the year at the same time, each word having a numerical value. Thus, the inscription, in reverse order, represents the year the CSIS was established: 1971.

Editor

J. Soedjati DJIWANDONO

Assistant Editor

Daniel SETYAWAN

Secretary

SOEDARSO

Advisory Board of Editors

Kirdi DIPOYUDO, Daed JOESOEF, Clara JOEWONO,
Rufinus LAHUR, A.M.W. PRANARKA, Pande Radja SILALAH1,
Djisman S. SIMANDJUNTAK, M. Hadi SOESASTRO,
Harry TJAN SILALAH1, A.R. SUTOPO, Jusuf WANANDI

The Indonesian Quarterly is published in January, April, July and October.

SIT

01381/SK/Dirjen PG/SIT/72

ISSN

0304-2170

THE INDONESIAN QUARTERLY

VOL. XVIII, NO. 1, FIRST QUARTER, 1990

Contents

From the Editor	2		
Current Events			
• The 1990/91 Budget <i>Mari PANGESTU</i>	3	• Japan, the USSR, and the PRC: Triangular Relationship in the Making <i>J. Soedjati DJIWANDONO</i>	56
• Conglomerates and Cooperatives <i>Hadi SOESASTRO</i>	8		
• The 28th Congress of Nahdlatul Ulama <i>M. DJADIJONO</i>	10	• The Major Powers and Regional Issues in Southeast Asia <i>Hasjim DJALAL</i>	66
• Two Years After the Manila Summit: The Future of ASEAN <i>C.P.F. LUHULIMA</i>	15		
		• Pacific Island Economies: Structure and Current Developments <i>Te'o I.J. FAIRBAIRN</i>	76
Articles			
• Southeast Asia in the Wider Pacific: Issues of Cooperation <i>Djisman S. SIMANDJUNTAK</i>	22	Book Reviews	
• The Role of PECC in the 1990s and Pacific Institutions <i>Jusuf WANANDI</i>	34	• Every Government Needs Golkar <i>ONGHOKHAM</i>	90
• Japan's Role in the Asia-Pacific Region: An ASEAN Perception <i>A. Hasnan HABIB</i>	44	• Islamic Banking <i>Mohsin S. KHAN</i>	92
		• Foreign Investment in Indonesia <i>THEE Kian Wie</i>	95

From the Editor

IN THIS ISSUE, attention is focused on the Pacific region. At the same time, however, the second anniversary of the Manila ASEAN summit is worth noting. Here lies the significance of Luhulima's commentary on the future of ASEAN, particularly as it relates to the Pacific region. It might as well serve as an introduction to the main body of articles dealing with some issues related to the region, which begins appropriately with Djisman S. Simandjuntak's articles on Southeast Asia and the Pacific.

Indeed, the *Quarterly* has previously published commentaries on the future of ASEAN. If there are different views and ways of looking at the issue, at least there is one commonality among the authors: they do believe that ASEAN has a future. That should augur well for ASEAN.

Jusuf Wanandi's article examines possible institutions by which to promote economic cooperation in the Pacific, particularly the role of PECC. The following three articles by Hasnan Habib, J. Soedjati Djiwandono, and Hasjim Djalal examine the roles of Japan and the other major powers of the region, their relationship with one another, and its impact on Southeast Asia, particularly as it relates to certain regional issues.

The last article by Te'o Fairbairn provides a comprehensive review of economic conditions and current developments in the South Pacific islands. This would be highly valuable information on which to base one's examination on the future roles of these South Pacific island states in the wider Pacific and their relationship with the rest of the region.

J. Soedjati DJIWANDONO

Current Events

The 1990/91 Budget

Mari PANGESTU

How Expansionary?

THE 1990/91 budget was announced on January 4th 1990 amidst speculation that civil servants' wages and the price of fuel would be increased. In fact as the new year was ushered in, several retail stores increased prices in anticipation of the fuel price increases. There was the 10 per cent increase in the wages of civil servants, but the price of fuel has not changed.

Compared with the last budget year, there is a 17 per cent increase in the 1990/91 budget (see column 8 in Table 1). However, to evaluate whether the increase is expansionary, one should compare the 1990/91 budget with an estimate of the realization of the current 1989/90 budget. Using estimated realized semester I figures for 1989/90 and a higher price of oil than budgeted, \$17/barrel instead of \$14/barrel, the expansionary effect is lessened.

The much higher oil prices imply that domestic revenues from oil are around 30

per cent higher than expected at Rp10.3 trillion instead of Rp7.9 trillion. Based on estimated for the first semester and reasonable assumptions, it appears that other non oil domestic revenues will reach the set targets.

On the other hand, routine expenditures will be slightly higher. This is due to the fact that the increase in the price of oil also means that there will be increased spending due to the need to subsidize fuel. Furthermore, since the 10 per cent increase in civil servants' wages will be effective on January 1st, 1990 rather than April 1, the beginning of the 1990/91 budget year, part of the increase will be felt in the current budget year. Estimates based on the first semester figures also indicate a slightly higher expenditure.

The substantial increase in revenues without a corresponding increase in routine expenditures, means that government savings are much higher than expected at Rp3.8 trillion instead of Rp1.8 trillion or twice as much. The balanced budget principle adopted by the government since the begin-

Table

ESTIMATED REALIZATION OF BUDGET 1989/90 AND PLANNED BUDGET FOR 1990/91
(Rp Billions)

	(1)	(2)	(3)	(4)	(5)	(4)/(1)	(5)/(4)	(5)/(2)
	Estim. Realiz. 1988/89	Budget 1989/90	Estim. Realiz. 1989/90 Sem. I	Estim. Realiz. 1989/90*	Budget 1990/91			
I. DOMESTIC REVENUES	23,004.3	25,249.8	13,088.8	28,127.9	31,583.6	1.22	1.12	1.25
A. Oil Revenues	9,527.0	7,899.7	5,392.7	10,310.1	10,783.2	1.08	1.05	1.37
B. Non Oil Revenues	13,477.3	17,350.1	7,696.6	17,817.8	20,800.4	1.32	1.17	1.20
1. Income Tax	3,949.4	4,947.6	2,365.9	5,257.6	6,515.8	1.33	1.24	1.32
2. Sales Tax	4,505.3	5,830.9	2,652.0	5,893.3	6,824.9	1.31	1.16	1.17
3. Customs Duties	1,192.0	1,421.2	826.4	1,652.4	1,971.9	1.39	1.19	1.39
4. Excise Taxes	1,389.9	1,487.0	679.9	1,589.6	1,911.2	1.14	1.20	1.29
5. Export Taxes	155.6	159.8	84.8	210.9	107.8	1.36	0.51	0.67
6. Land Taxes	424.2	638.5	196.8	504.9	620.4	1.19	1.23	0.97
7. Other Taxes	292.1	424.6	126.1	345.7	288.5	1.18	0.83	0.68
8. Non Tax Rev.	1,568.8	2,047.6	764.6	2,363.4	2,560.0	1.51	1.08	1.25
9. Receipts from fuel tax	-	392.9	-	-	-	-	-	-
II. DEVELOPMENT REV.	9,990.7	11,325.1	4,501.2	9,002.5	11,289.5	0.90	1.25	1.00
A. Program Aid	2,040.7	1,798.9	596.4	1,192.9	2,885.3	0.58	2.42	1.60
B. Project Aid	7,950.0	9,526.2	3,904.8	7,809.6	8,404.2	0.98	1.08	0.88
TOTAL	32,995.0	36,574.9	17,590.0	37,130.4	42,873.1	1.13	1.15	1.17
I. ROUTINE EXPEND.	20,739.0	23,445.0	11,484.5	24,348.2	26,648.1	1.17	1.09	1.14
1. Wages	4,998.2	5,966.5	2,968.8	6,184.7	6,909.3	1.24	1.12	1.16
2. Purch. Goods	1,491.6	1,476.6	739.0	1,733.2	1,720.9	1.16	0.99	1.17
3. Subs. Aut. Region	3,037.7	3,594.1	1,738.3	3,621.8	4,226.7	1.19	1.17	1.18
4. Interest and Amortization	10,940.2	12,236.8	5,712.4	12,236.8	12,984.4	1.12	1.06	1.06
5. Others	271.3	171.0	326.1	571.7	806.8	2.11	1.41	4.72
- Subs Fuel	133.1	-	240.6	400.7	626.5	3.01	1.56	-
- Other	138.2	171.0	85.4	171.0	180.3	1.24	1.05	1.05
II. DEVELOPMENT EXP.	12,250.7	13,129.9	5,928.7	12,782.2	16,225.0	1.04	1.27	1.24
A. Rupiah Funding	4,300.7	3,603.7	2,023.9	4,972.6	7,820.8	1.16	1.57	2.17
1. Govt. Dept/Inst.	1,861.3	1,474.0	891.7	-	4,316.0	-	-	2.93
2. Regional Dev.	1,485.7	1,759.1	740.6	-	2,834.5	-	-	1.61
3. Other	953.7	370.6	391.5	-	670.3	-	-	1.81
- Fertilizer Subs	200.0	155.0	155.0	-	155.0	-	-	1.00
- Capital Particp.	125.0	58.0	15.9	-	75.4	-	-	1.30
- Other	628.7	157.6	220.6	-	439.9	-	-	2.79
B. Project Aid	7,950.0	9,526.2	3,904.8	7,809.6	8,404.2	0.98	1.08	0.88
TOTAL	32,989.7	36,574.9	17,413.3	37,130.4	42,873.1	1.13	1.15	1.17
Govt. Savings (Dom. Rev-Rout. Expend)	2,265.3	1,804.8	1,604.3	3,779.7	4,935.5	1.67	1.31	2.73
Rp. Funding (Dev. Expend-proj. Aid)	4,300.7	3,603.7	2,023.9	4,972.6	7,820.8	1.16	1.57	2.17

Note: Govt. Savings for the Fifth Five Year Plan is Rp. 4,602.9

*Estimates are made based on estimates of first semester realization figures and extrapolating based on Semester I realization in 1988/89 except for: oil (the price of oil is estimated to be \$17/barrel compared with \$14/barrel so that the \$3 difference is multiplied by the estimated average increase of \$450 million per \$1 increase in the price of oil and the average exchange rate of Rp. 1,794.5/\$1); interest payment and amortization assumed to be the same as budgeted; income and sales tax assumed to have a higher realization in Semester I 1989/90 compared with 1988/89 of 45 per cent; customs duties, project aid, program aid, and other expend, assumed to be 50 per cent realized in the first semester; realization of fuel subsidy estimated as 60 per cent in Semester I; and rupiah funding is calculated as Develop. expend. minus project aid.

Source: Nota Keuangan 1990/91 and own estimates.

ning of the new order period means that spending has to increase or foreign borrowing to be reduced to absorb the increased government savings.

It is hoped that the former will not happen. The inflationary effects of increased government spending during the oil boom years which led to the Dutch disease phenomenon should be avoided. Instead the opportunity to reduce borrowing should be taken and this is the assumption that we use in the estimated realized figures for 1989/90 which are lower than budgeted at Rp9 trillion compared with the budgeted figure of Rp11.3 trillion. In the absence of detailed information regarding the pattern of disbursement and the details on the government projects being financed by foreign borrowing, the former number was obtained by multiplying the first semester figures by two, for want of a better assumption that is less ad hoc.

Comparison of the 1990/91 budget with the estimated realized figures of 1989/90 gives a lower growth of 15 per cent (see column 7). The growth expected for 1990/91 is in fact not that much higher or more expansionary than the current budget will be in comparison with the previous budget at 13 per cent. Furthermore, given that inflation will be around 6-7 per cent, the real growth is around 8-9 per cent.

The Revenue Side

The main increases on the revenue side in the 1990/91 budget are only from domestic revenues, with development expenditures not budgeted to increase at all compared with this year's budgeted figures. However, there is an increase in development expenditures if the comparison is with the esti-

mated realized figures for 1989/90.

The higher oil price assumption of \$16.5/barrel compared with the low \$14/barrel assumption used in the current 1989/90 budget implies that oil revenues are budgeted to be 37 per cent higher in 1990/91. Once again the increase is lower than estimated realized figures which are actually based on a higher oil price of \$17/barrel. Even though the price of oil is expected to be lower in 1990/91 than in 1989/90, nominal oil revenues are still higher due to predicted depreciation of the *rupiah* which is at present expected to be around 5 per cent p.a.

Non oil revenues are also expected to increase by 20 per cent, mainly income tax and non tax revenues which mainly come from state enterprise contributions. The impact of the tax reform in 1984 has really only begun in the last few years, beginning with the value added taxes (VAT) increasing in the first few years and income taxes increasing at rates of around 30 per cent in the last two years. The high growth for both VAT and income sales taxes are estimated still to be experienced in the current 1989/90 budget. The 1990/91 budget also reflects the continuation of high growth in income tax revenues but a slowdown in value added taxes growth as would be expected after the initial phase of high growth beginning from a small base is passed. As a result, the share of VAT and income taxes out of domestic has increased steadily from 37 per cent in 1988/89 to an estimated 40 per cent in 1989/90 and a budgeted 42 per cent in 1990/91.

The main reason for the increased tax revenues other than increased incomes can be attributed to increased efforts by the tax department to both widen the tax base and to increase tax collection from the existing tax

base. Efforts to widen the tax base include the amnesty on violators of the corporate tax in 1985 and measures introduced in the current budget such as extending VAT to telecommunication services and domestic air services, the extension of VAT to wholesalers and not just to retailers, the increase in VAT on luxury items (e.g. cars and alcoholic drinks) to 30 per cent. The tax on time deposits reintroduced in the banking deregulation in October 1988 should also increase tax revenues.

However, improved collection of revenues is an equally important factor. Intensified efforts of tax collection are reflected in improvements in the administration and management of tax collection, utilization of data from other government institutions for cross check purposes (e.g. passport applications and telephone accounts) and promotion schemes such as awards given to the highest tax compliers. Improved administration and management is a crucial factor. There has been continuous restructuring in the staffing and administration of the tax department with visible signs of improvement.

Non tax revenues which come mainly from state enterprise contributions are estimated to grow substantially in the current budget year at 51 per cent but the growth is expected to be 25 per cent in the 1990/91 budget year. Not much attention has been given to this source of revenue which in fact accounts for a sizeable share of domestic revenues at around 8 per cent. Efforts to increase contributions from the state enterprises, which would involve improved audit and monitoring as well as increasing the efficiency of its operations should be increased to achieve the aim of improved collection from this source of revenue. Since there is in-

creased source of revenues from taxes, there should be increased progressivity in the system of revenue collection.

Expenditures

On the expenditure side, routine expenditures are expected to increase by 17 per cent in the current budget year mainly due to the increase in wages and fuel subsidy related to the oil price increase. For the 1990/91 budget, routine expenditures are not expected to increase much or an estimated 9 per cent and mostly from wages, subsidy to autonomous regions and fuel subsidy.

However, after a period of fiscal austerity beginning with falling oil prices in the early 1980s and after the increase in this current budget, there is substantial growth in development expenditures. The budgeted increases are highest for development expenditures, with an expected growth of 53 per cent in the current budget year and an even higher increase of 200 per cent in the coming budget year. In the 1990/91 budget the increase mainly centred on expenditures related to government departments and institutions. The increase is almost three times and implies that the share of this expenditures out of development expenditures goes up from 35 per cent to 52 per cent.

It is still unclear what the objective is of such a high increase in government spending on government departments and institutions. The logical relation is with increased monitoring, especially with regard to development projects, and efficiency of the government machinery. It is hoped that the increase is not related to increased government intervention.

Development expenditures related to regional development also experienced high growth of 61 per cent in the 1990/91 budget year, but the share out of total development expenditures has actually fallen from 49 per cent to 35 per cent because of the huge increase in spending on government departments and institutions. There has been some improvement in the long debated issue of criteria related to the allocation of funds to the regions. The inclusion of area coverage is certainly an improvement in the right direction. Furthermore, the emphasis on expenditures to develop East Indonesia is also a positive factor to foster regional development. The important point is the realization of an obvious fact that in order to undertake regional development, there must be the basic infrastructure to attract investors to then develop the area into an economically viable one. Policies in the past to force investors to relocate to the regions without the concomitant development of infrastructure have been proven not to work. However, an important issue that remains to be seen since the implementation of the allocation of development funds to East Indonesia is as yet unclear, is decentralization. Who will be the authority to plan and allocate the funds, the central government or the regional government?

Government Savings: An Increase

An important development in the budget picture is the increase in government savings and the consequent result of increased *rupiah* funding to finance development expenditures being funded from government sources rather than from increased foreign borrowing. Government savings increased substantially from Rp2.3 trillion to an esti-

mated Rp3.8 trillion in the current budget year and is expected to increase to Rp4.9 trillion in the coming budget year. As a result *rupiah* funding increased substantially and project aid or development expenditure financed by borrowing fell in the current budget year and is budgeted to increase only slightly in the coming budget.

Conclusion

The 1990/91 budget is a good budget. Increased revenues from both oil and non oil sources have given substantial leeway for increased expenditures. However, while there is some increase in expenditures, there appear to be efforts to use the increased availability of revenues to lower foreign borrowing. This is sound long term policy. There is still a stimulating effect from government expenditure increases on growth, but without inflationary consequences that would result from too high an expansion. Reduced reliance on foreign borrowing will help reduce debt burden in future which is in line with Indonesia's adjustment and restructuring program.

The budget also contains a number of positive distributional aspects: the increased progressivity of the taxation system; increased development expenditure for regional development notably the emphasis on East Indonesia; and the increase in the civil servants' wages.

Speculation is still rife regarding the increase in fuel prices and it is unclear what the outcome will be. In order to introduce correct pricing of energy and thus influence efficient usage, and the increased fuel subsidy burden in the face of rising oil prices, there

appear to be compelling reasons to increase the price. It then becomes a question of timing. Speculation has in fact already increased

prices and it may be better to increase in stages rather than wait longer and have to increase the prices by a substantial amount.

Conglomerates and Cooperatives

Hadi SOEASTRO

DURING the second half of 1989, a heated discussion took place on the role of business conglomerates in Indonesia's economic development. The process of "going public" in a conspicuous way by a number of such conglomerates had raised further questions about business ethics, the integrity of big corporations, and concentration of economic power in the hands of a small number of business groups.

The debate highlighted three main views that prevail in the society. The first view proposes that the activities of such business conglomerates need to be controlled and limited through some kind of an "anti-trust" law. The second view focuses on the need of big corporations to take concrete measures as a manifestation of their social responsibility, and by so doing will become more acceptable, both socially and politically. The third view, which is the most extreme view, suggests that conglomerates have no legitimate place in the Indonesian economy. No consensus on this issue has been reached until this day.

In his annual budget speech in early January 1990, President Soeharto appeared

to have responded to the above debated issues when stating that big businesses and conglomerates have an important role to play in Indonesia's economic development, but that at the same time they are expected to fulfill their social responsibilities. A manifestation of such responsibility, as proposed by the President, would be for healthy private companies to make available up to 25 per cent of their shares to cooperatives. Loans, essentially subsidized loans, should be made available by the respective companies to enable cooperatives to purchase their shares.

The President's proposal rests on the following propositions. Firstly, "the going public by companies ... is a way to distribute more equitably the fruits of development and to make Indonesian businesses more open and more healthy." Secondly, "the purchases of shares through the stock market are still largely undertaken by the wealthier segments in the society." And thirdly, "cooperatives generally lack the funds to own shares and, therefore, they should be given the necessary loans -- by the corporations -- to purchase the shares of the respective corporations."

In addition, the President stipulated more specific guidelines. These include: (a) that cooperatives that should be given the opportunity to own the shares are the cooperative of the company's employees, primary cooperatives of that are in the vicinity of the company's location, and cooperatives that have production or distribution linkages with the company concerned; (b) that there will be no new regulations concerning foreign direct investment, but it is hoped that if the foreign partner in a joint venture plans to sell some of its shares to the Indonesian partner, priority should be given to cooperatives to purchase the shares; (c) that the implementation of this scheme be gradual so that in the future up to 25 per cent of the companies' shares will be owned by cooperatives.

A few days after the speech, the Coordinating Minister for Economic Affairs, RADIUS Prawiro, made it clear that the proposal was more of an "appeal" and not something "compulsory." He further suggested that in the near future the government would issue guidelines containing criteria of "healthy" companies and "healthy" cooperatives that could take part in the scheme. Minister RADIUS also stated that the target of 25 per cent was not definite and that cooperatives which own shares would not interfere in the management of the company.

Despite these additional clarification, a host of questions remain to be answered. If the 25 per cent target is to be taken at face value, the question is 25 per cent of what; of the total shares or of new shares that are issued in the stock market? Equally unclear is how the shares to be sold to cooperatives should be priced; the nominal price or the ongoing market price? These, indeed, are important questions that need to be addressed. Prof. Sadli has proposed a formula

that appears to be the most feasible under present circumstances. This model applies to companies that are going public and proposes that 25 per cent of the emission be reserved for the cooperative of employees. If this cooperative decides to purchase only a portion of the reserved shares, the remaining could be offered to other cooperatives. If after a certain time period these shares are not sold out, the company concerned is free to offer them to the public. A key to the feasibility of this scheme, which is stressed by Prof. Sadli, is the implicit subsidy provided by the company, either in the form of very soft loans or by setting a special price for the shares sold to cooperatives (see *MDBO/Tempo*, MDNM, January 20, 1990).

Although the desirability of increased social responsibility of private and big businesses is generally recognized, questions have also been raised as to why this should be confined to schemes involving cooperatives. There is widespread doubt about the efficacy of cooperatives as they are currently structured and organized. Thus, alternatives to the proposed scheme should also be designed and examined. An example would be the introduction of a program similar to ESOP (Employee Stock Ownership Program) in the United States. This is distinct from the proposed scheme in that it is oriented towards employees and individual ownership rather than towards the cooperative as an institution and collective ownership. There are many other alternative schemes, some of which have been implemented already by various Indonesian companies.

One model was that of PT Sinar Kasih, a publishing firm, in which a cooperative of its employees, established some 20 years ago,

managed to mobilized funds in the course of time through compulsory savings by its members, which led to the acquisition of close to 60 per cent of the company's shares. Another possible model, as proposed by Prof. Soemitro, is the establishment of a Cooperative Fund at the national (rather than firm) level, which receives financial support from the government, donations from major corporations, and contributions by cooperatives, which then can engage in the purchase of private companies' shares through the stock market.

It remains to be seen whether such alternative schemes would be seriously considered by the government and whether some greater freedom would be given to companies -- and their employees -- to select their own schemes, including those that do not involve cooperatives. It should be noted, however, that the President's proposal has two objectives. The one objective is to promote

greater social responsibilities on the part of private businesses, especially big businesses -- i.e. the so-called "conglomerates" that have come under severe attack from some quarters in the society. The other -- equally important -- objective is to strengthen and to promote the role of cooperatives as a pillar of the Indonesian economy. This latter objective is derived from an interpretation of the ideals of Indonesia's founding fathers as manifested in Article 33 of the 1945 Constitution.

In view of this "dual objective" it is important to recognize the complexity of the problem at hand. Therefore, the President's appeal cannot be implemented hastily. All involved parties need to think through their plans so that they can both be feasible and meet the objectives. The challenge lies not only with private businesses but also with the cooperatives themselves.

The 28th Congress of Nahdlatul Ulama

M. DJADIJONO

ON 25-28 November 1989 the 28th Congress (Muktamar) of NU¹ was held in Yogyakarta. The Muktamar, which is held once every five years is the supreme governing body of the organisation. The 28th Muktamar was attended by about

¹Nahdlatul Ulama now refers simply to Indonesian Moslem Scholars' Association. Literally Nahdlatul Ulama means the rise of (Moslem) scholars.

2,000 participants and observers (including foreign ambassadors and scholars). Four major issues were discussed in the Muktamar, namely: religious and social affairs, election of a new executive board for the period of 1989-1994 and general affairs; and recommendations for the implementation of national development programme and its impacts.

Though an internal affair of the organisation the Mukhtar attracted the attention of various circles including the government and political parties as well as the public at large. The considerable interest of the government in NU's 28th Mukhtar was affected by the presence of the President himself to officiate at its opening. Moreover, five ministers each delivered an address. Even the armed forces assisted the Mukhtar with 100 personnel of *Korem 072/Pamungkas* (Military Command at a level below the residency in Yogyakarta) in catering facilities. The political parties even showed their interest by providing financial assistance.

This brief commentary will discuss two main issues. The first is the question as to why the political organisations paid such a considerable attention to the Mukhtar. The second question is concerned with the internal and external significance of the outcome of the Mukhtar.

When established in 1926, Nahdlatul Ulama was an Islamic religious organisation with traditional orientation, in the sense that most of its members lived in rural areas and their views on the Islamic religion were mostly based on the "fatwa" (guidance on religious matters) of elderly *Kyais* (Kyai = venerated Moslem scholar) and classical books better known as *Kitab Kuning* (Yellow Book). By contrast, another Islamic organisation (Muhammadiyah) has been generally considered as being progressive, rational and modern in its orientation.

In the past, NU used to be actively engaged in practical politics. Initially the organisation formed a federation with the Masyumi party (*Majelis Syuro Muslimin Indonesia* = Council of Indonesian Moslems

Association). However, before the first General Elections (1955), on May 1952 in its 19th Mukhtar in Palembang (South Sumatra), NU announced its split with the Masyumi party and its independence as a political party. The main source of its conflict with Masyumi centred on NU's position in the party's leadership, particularly as regards the post of Minister for Religious Affairs.² In the general elections NU came out as one of the four major parties obtaining 45 seats in the DPR (House of Representatives). The other three major parties were the PNI (Indonesian Nationalist Party) with 57 seats, Masyumi 57 seats and the PKI (Indonesian Communist Party) 39 seats.

NU's existence as a political party continued until the general election in the New Order period (1971), in which NU obtained 58 seats in the DPR whereas the three other Islamic parties (Partai Muslimin Indonesia, Partai Syarikat Islam and Partai Persatuan Tarbiyah Islamiyah) together only obtained 36 seats.

Further, in 1972-1983, when the New Order government called for the reduction of the number of political parties and social organisations, NU opted for a fusion into the United Development Party (PPP). This was maintained until the 1982 General Elections.

NU's existence within the PPP appeared to have caused disappointment with certain political disadvantages. One disadvantage was the fact that PPP did not seem to respect

²See H. Abdul Basit Adnan, *Kemelut di NU antara Kyai dan Politisi* (Solo: Mayasari, 1982) pp. 24-29, see also Syamsuddin Haris, "NU dan Politik: Perjalanan Mencari Identitas," a paper presented at the One Day Seminar of AIPI (Indonesian Association of Political Scientists), Jakarta, 14 December 1989 pp. 7-8.

NU's "greatness." For instance, in preparing the list of DPR candidates for the 1983 General Election, PPP's General Chairman put the names of NU's candidates at the bottom of the list. This improper treatment of NU seemed to continue during the election of DPR committee leaders after the 1982 General Election.

In its 27th Muktamar in Situbondo (East Java) in 1984 NU decided to part formally with the PPP. From then on NU has returned to its original identity generally known as the "Return to the 1926 *Khittah* (Route)," namely as a socio-religious organisation while giving its members freedom to vote for any political organisation of their own choice in general elections.

NU's existence as a socio-religious organisation had been consistently maintained until the 28th Muktamar. The chairman of the organisations commission formed by the Muktamar, K.H. Jusuf Hasjim, while announcing the decisions of the commission explicitly said that "Even if the MPR (People's Consultative Assembly)'s Decree on Political Parties and the Functional Group (Golkar) should be changed so as to create four or five organisations instead of the current three political parties, NU would not be persuaded to become a political party again."³

There are at least three factors that have attracted the attention of people to NU. Firstly, NU has a very large membership (30 million).⁴ In addition, according to the 1989-

1994 NU Board, NU nurses 5,268 educational units ranging from Kindergarten to universities. It has also various institutions such as the Institution for *Dakwah* (propagation of faith), the Mubarrat (divorce at the request of the wife) Social Institution, Institution for Family Benefit (LKK), Institution for Agricultural Development, Art Association and others. It also has a number of autonomous bodies such as Muslimat NU (NU Moslem Women), Fatayat (female youth) NU, Ansor Youth Movement, NU Boys Association, NU Girls Association, Indonesian Islamic Association and the like.

Secondly, the Muktamar was held in anticipation of the 1992 General Election. Thirdly, NU's programme is populist in nature and its benefit can be immediately felt by the people at large.⁵

NU's members totalling 30 million has a very great political significance. If the requirement to become a member of NU, which according to NU's statute drawn up by the 28th Muktamar, Article 7 clause (1) "has come of age (*akilbaligh*)," can be interpreted as having a franchise, NU members constitute a very large number of voters. In the previous 1987 General Election the number of voters throughout Indonesia was about 94 million. It means that the voters contributed by NU will be around 35 per cent.

Since NU has given its members a free hand to vote for any party in the general elections, any party able to attract NU members will very likely gain a considerable

³See *Antara*, 28 November 1989.

⁴One can compare it with other socio-religious organisations (Islamic), namely Muhammadiyah, with members totalling only about 6-7 million (according to Dr. Zamaksyari Dhofier in *Suara Karya* daily, 29

November 1989); Moslem Students Association (HMI), according to then HMI's General Chairman Widyananda, with only about 150,000 members (*Merdeka* daily, 2 November 1989).

⁵Editorial of *Kompas*, 24 November 1989.

additional number of votes in the general elections. In the 1987 General Election, when NU embarked on a drive to drastically reduce PPP's position in its election campaign, it resulted in a considerable reduction of PPP voters in NU bases in the regions. In Central Java PPP lost 4 seats for the DPR, in East Java 8 seats, in West Java 3 seats and in South Kalimantan 2 seats.⁶

Meanwhile the government also paid a great attention to NU since the government needed its political support. The government may also make use of NU to communicate national development programmes to the common people.

NU's 28th Muktamar make 4 kinds of decision related to: (1) NU's stance on Islamic norms in social matters; (2) NU's stance on politics; (3) organisational affairs; and (4) recommendations for national development. Of great importance are the Muktamar's political decisions incorporated in Nine Directives in Politics for NU members. Of the Nine Directives, the most important ones state that: (1) to be engaged in politics implies the overall involvement of the citizens concerned in the life of the state and the nation in line with Pancasila and the 1945 Constitution in order to develop essential and democratic values educating the nation towards maturity in order that the people may be aware of their rights, duties and responsibilities for their common benefit; (2) to be engaged in politics NU members should have a national outlook orientated towards national integration in order to realise a just and prosperous society, which is based on the morals, ethics and culture of Pancasila; (3) under no pretext whatsoever may NU

members be engaged in politics by sacrificing common interests and sowing discord.⁷ Such a political posture may be understood in that NU makes a distinction between observing the teachings of religion and being engaged in politics, without confusing them.

Apparently the decisions of NU's Muktamar will have a significance internally and externally. Internally it is related to NU's identity with regard to the norms of Islamic religion and NU's existence in the future. Externally, it is the possibility of the impact of the Muktamar's decisions on the Islamic view in both politics and the development of Indonesian national political life in the future.

Internally, the Muktamar's decisions may increasingly make NU's identity more distinct in the members' religious, social or political life. Accordingly, the existence of NU as a socio-religious organisation will be increasingly easier to understand by both NU members themselves and the Indonesian Islamic community in general.

The distinction made between observing the teachings of (Islamic) religion and practical politics may give rise to debates among the Indonesian Islamic community. This is due to the fact that among Indonesian Islamic circles are still those who contend that religious life is inseparable from that of politics; to be engaged in politics also means to carry out one's religious mission to uphold the Islamic law. This thinking is based on the belief that aside from being an ideology Islam also covers all aspects of human life (the ideological, political, economic, socio-cultural aspects as well as defence and security), the relationship between man and man,

⁶M. Sudibjo, "Pemilihan Umum 1987," *Analisa* vol. XVI, no. 7 (July 1987) p. 652.

⁷*Angkatan Bersenjata* daily, 28 November 1989.

between citizens and the state, and between man and God.

Externally, the decisions of the Mukhtar may change the perception of society on NU's nature and identity. To date NU has often been viewed as a socio-religious organisation (Islamic) of traditional character. But profound changes have happened within NU which are orientated towards very progressive views.

NU's progressive views can be observed from the decisions of the Mukhtar which essentially assert that the teachings of religion should be adjusted to social development. This is noticeable, for example, in its views on medical technology advancement. NU allows the method of test-tubes babies, transplantation of body organs and the like. The organisation thinks that social life should not be organised on the basis of dogmas or the teachings of religion. On the contrary, the practice of religion has to be adjusted to development of social conditions in accordance with the existing rules of law in Indonesia.⁸

⁸When it was still a political party, NU did among other things aim at upholding the Islamic law (Sjari'at) and making efforts in the enforcement of Islamic law in society. However, it was limited by the provision that the principles and aims were not opposed to those of the state. This is different from Masyumi's principle, which stated in its Statute that *Masyumi's aim was to uphold the sovereignty of the state and Islamic religion and to carry out the Islamic ideals in state affairs*. Now, after its return to its status as a social organisation, NU's aim is "to put into effect the teachings of Islamic religion in line with *ahlussunah waljama'ah* (the people who keep to the *sunna* -- usage -- of the Prophet, in community with the one great *umma* or *djama'a*, in short the orthodox -- in the sense of 'orthoprax') and to adhere to one of the four *madzhabs* (orthodox schools of law) in daily life, in the Unitary State of the Republic of Indonesia, which is based on Pancasila and the 1945 Constitution, its sole principle.

Another advancement may be observed from the decision of the Mukhtar on the Political Directives. This view no longer confuses politics with religion or puts politics under the authority of (Islamic) religion as opposed to the view still adhered to by some Indonesian Islamic circles. On the contrary, the decision distinguishes the practising of the teachings of (Islamic) religion from being engaged in politics.

Of the nine directives in politics for NU members not a single sentence suggests that the implementation of practical politics is to be the practice of religion or to be engaged in politics also means to practise (Islamic) religion. On the contrary, in being actively engaged in politics, NU members should base their activities on the universal political values such as independence and democracy, national unity and defer to the national consensus of the Indonesian people, namely Pancasila and the 1945 Constitution. If there is any directive of religious character, even then it cannot be simply contended that it is aimed at upholding the teachings of Islamic religion but at consolidating national consensus and achieving common ideals.

It is obvious that the views of NU are increasingly progressive. The only element of orthodoxy inherent in NU lies in its stance on mixed marriage between people of different religions, which is still forbidden. Nevertheless, in view of the increasingly open interaction among various religious believers in Indonesia and owing to the views of Chairman of the Advisory Council (Majelis Syuriah) K.H. Achmad Siddiq and Chairman of Tanfidziah H. Abdurrahman Wahid, sooner or later, that orthodoxy will very likely also undergo a change.

Two Years After the Manila Summit: The Future of ASEAN

C.P.F. LUHULIMA

FOURTEEN YEARS after the Bali Summit and two years after the Manila Summit's evaluation of ASEAN's progress as a great achievement in regionalism, political and economic nationalism will still continue to remain the "obstructionist wall" to a higher degree of cooperation into the 1990s. The dramatic changes in the international political and economic environment which gained momentum since the end of the 1980s will inevitably put further pressure to bear on ASEAN cooperation: to lower the "obstructionist walls," to redefine the principle of consensus in ASEAN decision-making which was designed to safeguard the national interests of member nations, to redirect the regional bias and degree of complementarity in economic relations to the ASEAN region instead of to the broader region of the Pacific, and to step up ASEAN's political acumen in settling regional disputes and developing balanced and equidistant political and security relations with the major powers in the region.

The External Environment

The international political environment will be one of far-reaching adventures in the

Originally prepared for ASEAN-Pacific Islands Conference, Bali, October 1989 organised by CSIS and East West Centre.

dialectics of disequilibrium and equilibrium. The Soviet Union under Mikhael Gorbachev has embarked on an unprecedented adventure into the unknown, politically and economically. Marxism-Leninism will continue to yield to the vigour of Western democratic ideas and market economics. Gorbachev's political back-up by Soviet parliament which he brought into the world and which has developed into an alternative to the Communist Party as a centre of power will presumably safeguard his political, ideological and economic reforms as well.

The resultant detente between the Soviet Union and the United States will continue the process of allaying mutual suspicion and promoting mutual understanding and trust. However, the trend towards mutual confidence-building measures by each does not preclude the continuation of their competitive relationship. They will continue their rivalry for domination, ideologically, politically or otherwise, although in a more sophisticated way, more diplomatic, hence less militaristic and less marked by violent initiatives.

The Sino-Soviet detente will also play a major part in reducing international and regional tension in the Pacific. Both have a strong motivation for normalisation of their relations and for a stable and peaceful international environment in order to successfully

conduct their domestic reforms and modernisation, although they will continue to be engaged in a competitive relationship as well. Deregulation in the Soviet Union moves beyond the economic realm, into the realm of politics and ideology, in contrast to the Chinese exercise. The process of rapid economic change in China is expected to further result in greater potential for a clash between economic development and the requirements of political stability and openness. However, systemic political changes in the 1990s will occur in an evolutionary rather than in a revolutionary way in the East Asian region.

The international economic environment will be one of far-reaching adventures in the dialectics of regionalism and multilateralism. The 1990s will continue to witness the decline of the United States hegemony which earlier guaranteed the stability of GATT as the major component in the global trading regime. What this decline primarily implies is the lack of leadership. And this is vividly being experienced by ASEAN. America's decline over the last couple of years has reflected itself in its campaign for fair trade versus free trade, resulting in the concessions ASEAN had to make for the sake of market access into the United States.

The trade war between the United States and Japan and to a lesser degree with EC12 will sharpen although it will simultaneously be accompanied by various endeavours of compromises of economic interests. Japan has also been severely warned by the EC Commissioner for Competition to further open up its market lest reciprocal measures be launched to stem the penetration of Japanese interests in the Community. The entrance of the Socialist economies into the world economy will certainly expand the in-

ternational market.

The instability of GATT or of economic multilateralism has resulted in the emergence of economic regionalism world-wide. The European Community of Twelve (EC12) have committed themselves to engage in the creation of the single market in 1992. This has already started to lead up to the diversion of economic resources from non-Europe to Europe, in the case of the United States, Japan and the 4 "first degree" NIEs in the context of export substitution. The United States and Canada have established the North America free trade association which will probably be extended to include Mexico and other Latin American countries. And Australia and New Zealand have also engaged themselves in a free trade association if only of very limited effect on other parts of the world. In Manila in 1987, ASEAN's heads of government agreed on a substantive programme of intra-ASEAN trade liberalisation which will logically mean an ASEAN free trade area. Here again the futility of the struggle for the establishment of the New International Economic Order will be heavily emphasised. The issue is whether this new order still has its relevance in the now widely accepted trend of market economics, even by the socialist economies.

The advanced Pacific countries have since the second half of the 1960s ventured into seeking organisational configurations for Pacific cooperation to safeguard themselves against the perceived threat of the European Economic Community. The latest proposal by Australian Prime Minister Robert (Bob) Hawke introduced in Korea early this year was motivated by the Single European Market initiative. The idea is to review the growing economic linkages among the Asia-Pacific economies, to iden-

tify the region's common interest in the Uruguay Round and to start addressing issues of trade expansion and liberalisation in the Pacific region. The coordination of the Hawke's initiative with the already functioning Pacific Economic Cooperation Conference (PECC) will be a most fruitful exercise.

Specific Issues Facing ASEAN

The international developments described earlier have simultaneously indicated that many of the world's problems and issues have an independent existence of their own. In many areas political solutions cannot be imposed from Moscow and Washington or from both acting in concert. Despite greater understanding among the major powers, the battles in Cambodia and Afghanistan -- apart from the feeble hopes for a solution to the Middle East problems, and the civil war in Sri Lanka -- are again intensifying. But now the blame for these pertinent ills can no longer be put on the superpowers or major powers. The settlement of regional conflicts will become predominantly the responsibility of the regional powers. The regional capability to manage conflicts will thus have ample opportunity to develop. For the Southeast Asian region, the pertinent issue of security and stability has surpassed the Cambodian dimension. The motivation to initiate JIM III should be weighed against the prospective incorporation -- whether wholly or partially by sectoral initiatives -- of Vietnam as a major factor in the ASEAN endeavours to realise the Zone of Peace, Freedom and Neutrality.

The issue of the United States and Soviet military facilities will become less relevant in view of the promotion of rapprochement be-

tween the superpowers, on the one hand, and the progressive limitations on defence budgets as well as domestic political pressures and the development of sophisticated weapon systems, on the other. The Soviet Union has indicated that they will withdraw from their military facilities in Cam Ranh and Danang and have put out a number of feelers. So have the Americans. The reluctance with which they are handling the issue of military facilities in the Philippines is proof of that. Both are looking for ways to wind up their military presence in the Southeast Asian region, which does not mean, however, the termination of their overall presence.

The Southeast Asian waters will remain the main sea lines of communication (SLOC) between the Indian and Pacific Oceans, between the Gulf of Persia and Northeast Asia, and between the Soviet Far East and the European part of the Soviet Union. Hence, the proclamation of Southeast Asia as a nuclear weapons free zone will encounter a far greater number of objections than did the proclamation of the South Pacific Nuclear Free Zone.

Indonesia's endeavours to reopen diplomatic relations with China will soon be followed by Singapore and Brunei Darussalam. This major diplomatic initiative will open up numerous channels of formal and informal communication to accommodate the interests of both China and ASEAN including those in Cambodia and in the South China Sea, particularly as regards the Paracel and Spratly islands. All ASEAN countries view the tension in the South China Sea as a factor undermining the region's stability and threatening the freedom of the SLOCs. Potential causes of conflict of ASEAN countries with extra-regional powers may further

arise from the safety and freedom of navigation, overflight and the laying of cables and pipelines, from the rights of visit, innocent passage, scientific research and fishing as well as violations of principles of international law or general practice and activities deemed prejudicial to the peaceful order and security of the coastal states.

The need to step up national and regional resilience does not, however, imply that external assistance will not be required, especially from the United States, the Soviet Union, or from China and Japan. Many problems will still be arriving at their doors, on the classical arguments of superpower and major power rivalry or the moral obligations of the rich towards the poor. But **equally many constraints will prevent them** from extending aids and assistance. Foremost among them are economic assistance.

Hence, greater economic cooperation is a *sine-qua-non* for ASEAN's resilience. ASEAN has since the Bali Summit worked out a great number of schemes of economic cooperation in the fields of trade, industry, tourism, agriculture, energy, science and technology, finance and banking and many more. The aims of these schemes are transparent enough. Conscious of the lack of regional bias towards ASEAN and of complementarity among ASEAN economies, the promotion of both has been the most significant aims of ASEAN economic cooperation. A renewed effort was made at ASEAN's Third Summit in Manila to improve the ASEAN Preferential Trading Arrangement (PTA) in order to further boost intra-ASEAN trade. It was a renewal of commitment to ASEAN cooperation and sectoral integration as is evident from the 1988-1992 programme to expand its coverage and to deepen its margin of

preference on the basis of an across-the-board or a product-by-product concession or a combination of both.

Similar arrangements apply to the ASEAN Industrial Joint Ventures. AIJV products are to enjoy a 90 per cent margin of preference in the participating countries. A waiver period of MOP is to be extended from four to eight years for non-participating member countries incapable of offering reciprocal MOPs. Their objective is to significantly increase the flow of investments into the region and to raise intra-ASEAN investments to at least 10 per cent of total foreign investment by the year 2000 as well as to step up manufacturing value-added at an annual rate of 8 per cent. These policy measures were intended to compensate for the relatively low degree of complementarity and thus high intra-trade resistance within ASEAN. The trade bias towards the Pacific, particularly towards the United States, Japan and the NIEs, has resulted in the fact that more than 70 per cent of ASEAN exports goes to the Pacific area. Both schemes, the ASEAN PTA and the AIJV are endeavours to redirect trade and industrial biases and complementarity from the greater Pacific area to the ASEAN region and to build up a power-house of trade directed towards both the Pacific and the European Community of 1992.

The spectacular changes in the structure of GDPs of ASEAN countries away from primary commodities towards manufacturing and modern services will continue to increase and will thus imply a greater opportunity for intra-ASEAN trade as well. Domestically it means a move away from import substitution policies toward export-driven development in all ASEAN countries. The changing structure of the economies and

the re-orientation in development strategy have an important implication for the highly prioritised investment sectors. All ASEAN countries are paying greater attention to high-technology industries, such as chemicals, machinery, telecommunication and information.

However, a number of Manila Summit directives cannot be executed satisfactorily until the incompatibilities in national and regional policies are resolved. Regional economic policies seldom or perhaps do not at all feature in national development programmes of the member countries. Hence, the lack of policy coordination, such as disagreement on economic outlooks, economic objectives, means-end relationship, and, above all, on the distribution of gains from cooperation, all of which have so far hampered ASEAN deliberations on PTA, AIJVs and other regional cooperation schemes.

Meanwhile, the ASEAN Economic Ministers (AEM) have reacted favourably to Hawke's proposal on regional economic cooperation, although with some reservations: the November meeting was not to be used to launch a new programme, but was viewed by ASEAN as an initiation of informal consultations on economic matters of common interest to countries in the Asia-Pacific region. It should not lead to the perception or formation of a trading bloc.

The mechanism for the consultative meeting should be an extension of the AEM meeting and as such the AEM is ready to host a second meeting. This six-plus-six meeting (ASEAN, Australia, New Zealand, Japan, Republic of Korea, Canada and the United States) can be attended by the secretary general of the South Pacific Forum (SPF) as observer. The issues ASEAN would like to discuss range from international eco-

nomic development, structural adjustments and regional growth, trade interest, to regional cooperation in investment and technology transfer and human resources development.

An Agenda for the 1990s

It is not the intention of this commentary to provide neat recommendations for a politico-economic design or strategy with a view to the developments and trends into the 1990s and beyond. What it attempts to do is to highlight a number of fundamental issues towards which the ASEAN member countries should take common positions.

To begin with, especially in the light of the various developments and trends described in the preceding pages, ASEAN member countries will have to decide in the next decade whether the Association is to remain a loose organisation, a dependent variable, an entity whose major function is to support its member countries' national interests or national developments or whether it should tighten the organisational structure beyond the configuration of a free-trade area and become an independent variable. This would mean extending more power to the Secretary General of the ASEAN Secretariat and to institutionalise the Joint Ministerial Meeting of foreign and economic ministers which is to be convened "as and when necessary" into the ASEAN Council of Ministers with a regular schedule of meetings.

Closely related to this point is the need to reformulate the concept of each individual member nation's national interest. The principle of consensus in decision-making is essentially a safety device to assure member

nations that their national interests will not be sacrificed. However, ASEAN's dependence or rather over-dependence on exports to the developed economies which have increasingly protected their markets by various non-tariff barriers despite assertions of allegiance to GATT already have compromised the economic interests of the individual member states. These interests will be further compromised by the global slide towards economic regionalism, of which the most important are the Single European Market and the United States-Canada trade area, ASEAN's huge export markets. Entering these big markets will certainly mean reciprocity in the sense of fair trade, which in the case of EC92 may also mean pressure towards the unification of ASEAN's six markets. So is ASEAN's dependence on the major powers to resolve the Cambodia problem, the realisation of the Zone of Peace, Freedom and Neutrality and its Nuclear Weapon Free Zone component. Hence, ASEAN may have to introduce majority voting in their decision-making to encounter these issues.

Here, national and regional resilience may play a significant role. A state may claim to be resilient when its political system is accepted and is capable of meeting the increasing demand for better security, greater prosperity and social justice, and thus its capability to cope with insurgencies, subversion, as well as adverse external influences and interference. If national resilience is centred on the political acceptance of the state and its capability to fulfill the demand of the people for greater security, wealth and social justice, then regional resilience should equally be centred on the political acceptance of ASEAN and its capability to provide greater security, economic prosperity and social justice in the region.

A comprehensive concept of regional resilience was only suggested by the participants in the first ASEAN Seminar on Regional Resilience (ASORR I) held in Jakarta in February last year and circulated among member countries: it is a dynamic condition within the ASEAN region reflecting the status-of-the-art of the national resilience of each member country, the levels of interaction among them, their commitment to the region and the regional capability to adapt itself in facing the challenges and opportunities. It is, one could add, a condition to develop ASEAN's capability to manage the region's internal dynamics and external influences for the maximum benefit of the region. Interference by external powers should thus first and foremost be met by strengthening national and regional resilience.

Both national and regional resilience should be perceived as conditions which are conducive to the establishment of the Zone of Peace, Freedom and Neutrality. At the regional level, ZOPFAN seeks to promote an awareness of a Southeast Asian identity, an awareness which is capable of diffusing or abating and finally removing mistrust and thus perceptions of threat from within the region. At the extra-regional level, ZOPFAN seeks to strike a balance among the major powers in the region. Although no precise degree of equilibrium is envisaged, the equation reached shall not endanger the territorial integrity and sovereignty of any Southeast Asian state. An equilibrium of interests on the basis of the understanding of the major powers would prevent patterns of behaviour threatening national and regional stability in Southeast Asia. And the current **rapprochement** among the United States, the Soviet Union and PRC are conducive to the further promotion of ZOPFAN in the 1990s.

A weak national and regional resilience is a major reason for bilateralism in security and economic relations with the big powers. ASEAN will have to take steps to intensify its cooperation and discontinue the need for each member state's bilateral relations with the external powers which may result in greater dependence and closer alliance to the detriment of itself. The member countries are gaining more by dealing collectively rather than bilaterally with the United States, Japan, the European Community, China and the Soviet Union. The advocacy of ZOPFAN, Nuclear Weapons Free Zone, the PTA and AIJVs are all designed to reduce the bias and increase complementarity in the region.

Finally, the fact is to be noted that regional economic policies are not integrated into the national development plans of the ASEAN member countries. The PTA and AIJVs should become intrinsic factors in the industrialisation and trade strategies of the

member countries to discontinue the habit of placing greater emphasis on the exclusion rather inclusion lists. The probability of improvement would be augmented if a number of pressure groups were to emerge which would urge the consistent execution of the new policies which strongly emphasise exports, most importantly in the private sector, such as within the ASEAN Chambers of Commerce and Industry and its numerous industrial clubs.

Over the last two decades ASEAN has become an important variable in the foreign policies of all member states and any attempt to disengage from this variable will result in the destabilisation of the region, in turning the clock back in ASEAN's painstaking efforts in achieving security and stability for the whole region. There is thus no turning back for Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand in designing policies and strategies for the next decades.

Southeast Asia in the Wider Pacific: Issues of Cooperation

Djisman S. SIMANDJUNTAK

THE LAST three years have been a period of hope for Southeast Asia. The solution to the Kampuchean problem seems near, though the expected breakthrough has failed so far to materialize. ASEAN countries which in terms of population constitute by far the largest part of Southeast Asia have managed to return to a high growth path. At the same time, the world at large is experiencing rapid changes of which some are bound to have far reaching implications for Southeast Asia, for better or for worse. Adjustment to these changes should be ranked very high in the agenda of Southeast Asia for the next few years. In doing so, countries in this region can capitalize on the extensive links they have already established with the wider Pacific, which in turn is also forced to adjust to the changes taking place elsewhere, especially in Europe.

The first part of this paper deals with the links that Southeast Asia now has with countries in the Pacific, especially the economic links. Taking into account the various changes in the surroundings of Southeast Asia, issues of cooperation will be explored in the second section before we proceed to discuss the strategies which are open to Southeast Asia while trying to maximize the benefit from its participation in cooperation in the wider Pacific.

Links with the Wider Pacific

Pacific countries in general and the developed countries in particular have always been among the important partners of Southeast Asia, at least from the economic point of view. The fact that the Pacific emerged as the world's growth centre in the 1980s is an historical opportunity for Southeast Asia which unlike most developing regions, is strongly committed to economic developments as a way of emancipating itself in the global community.

Paper presented at the conference on "The Future of Southeast Asia," Kuala Lumpur, November 1989, organised by ISIS (Malaysia).

To appreciate what ASEAN countries have achieved in the last three years in terms of economic progress, one may recall the pessimistic scenario pictured by different observers when in 1986 the prices of primary commodities fell to a very low level. The fear was expressed that because of the weak commodity market, foreigners might find ASEAN unattractive as an investment location. Relatively low wages were perceived to be of diminishing importance as an ingredient of international competitiveness in labour intensive industries. This pessimistic scenario was, however, based on the assumption of a rigid policy environment which in fact proved to be wrong.

In reality, the second half of the 1980s turned out to be a period of far-reaching economic reforms as far as Southeast Asia is concerned. Singapore announced in 1986 new directions of economic policy, drawn after intense policy debates. Between 1982 and 1988, Indonesia announced countless of reform packages which also amounted to new directions in economic policy in spite of different inconsistencies, particularly as regards the implementation of the reforms. Malaysia also relaxed the restrictions embodied in its New Economic Policy. Even the Philippines which had to go through a very difficult period of debt renegotiation under a tumultuous political environment, managed to maintain an adequate support to the reform course it had been taking since early 1980s. These national initiatives were reinforced by the agreement reached by the Heads of Governments of ASEAN during their Manila Summit at the end of 1987, to substantially liberalize intra-ASEAN trade and investment in the following five years.

Limited space does not permit a thorough discussion on all the policy ini-

tiatives taken by the governments in ASEAN while responding to the changed environment. Broad discussion is, however, needed in view of the implications of the reforms for the participation of ASEAN, individually and collectively, in any cooperation initiative in the wider Pacific.

A prudent macroeconomic policy was one of the main characteristics of policy environment prevailing in ASEAN countries in the 1980s. There was a firm commitment to monetary stability even in the immediate period following the bust in commodity prices which, in historical perspectives, oftentimes led to an inflationary spiral as governments resorted to money printing to compensate for the decline in real revenue from commodity taxation. Flexibility in foreign exchange management also strengthened, helping to improve the domestic terms of trade in favour of export and to reduce bias against capital import. Reforms were also undertaken in the area of public sector economy. Simplified tax laws with reduced rates were adopted in Indonesia. Singapore's Central Provident Fund was among the main elements of the new policy adopted in 1986. Furthermore, privatization was pursued at different speeds in each of the ASEAN countries with a view to improving the performance of the relatively large public sector enterprises and, thereby, to relieving the rest of the economy of the "high cost" usually associated with a state enterprise.

Of equal importance were reforms in microeconomic policies. Trade policy was starkly rationalized in the case of Indonesia, the member of ASEAN which in the past was known as the least liberal in terms of trade regime. Non-tariff barriers, notably import licencings, were greatly reduced

Table 1

1989-90 FORECAST OF REAL ECONOMIC GROWTH AND INCREASE OF CONSUMER PRICES
OF FOURTEEN ECONOMIES
(Per Cent)

	Real GDP/GNP			Change CPI		
	1988	1989	1990	1988	1989	1990
Australia	3.7	3.5	3.0	7.2	7.5	8.5
Canada	5.0	2.9	1.8	4.0	5.1	5.6
China	11.2	6.6	6.5	18.5	21.4	11.4
Hong Kong	7.4	4.5	4.0	8.7	12.0	9.0
Indonesia	5.5	5.6	5.7	8.4	11.6	11.7
Japan	5.7	4.8	4.0	0.5	2.1	2.4
Korea	12.2	7.2	7.4	7.1	6.5	6.5
Malaysia	8.7	6.9	6.1	3.5	4.1	4.8
New Zealand	0.6	2.9	2.1	4.7	6.4	4.7
Philippines	6.8	6.0	6.6	8.8	11.1	8.8
Singapore	11.0	8.5	7.5	1.6	4.0	3.5
Chinese Taipei	7.8	7.1	7.2	1.3	3.9	3.1
Thailand	11.0	10.0	8.5	3.8	5.0	5.0
United States	4.4	2.9	2.5	4.0	4.8	4.4
Average of All Countries	7.2	5.7	5.2	5.9	7.5	6.4
Average, Excluding US & Japan	7.5	6.0	5.5	6.5	8.2	6.9

Source: Pacific Economic Outlook.

Table 2

1989-90 FORECAST OF EXPORT AND IMPORT GROWTH OF FOURTEEN ECONOMIES
(Per Cent)

	Export Growth			Import Growth		
	1988	1989	1990	1988	1989	1990
Australia	3.2	2.0	4.0	17.2	20.0	7.5
Canada	9.5	1.6	2.9	13.9	6.8	2.9
China	20.8	6.4	14.2	28.0	10.0	7.5
Hong Kong	30.4	12.0	8.5	32.6	13.0	8.5
Indonesia	6.7	8.5	8.0	1.9	6.7	5.2
Japan	4.3	6.0	5.5	17.4	12.5	10.5
Korea	14.7	1.0	4.5	11.8	11.5	9.5
Malaysia	17.0	13.2	11.2	21.3	16.2	15.8
New Zealand	3.3	3.5	3.1	-5.7	4.4	2.7
Philippines	14.8	12.9	10.8	37.0	14.9	9.6
Singapore	32.0	20.8	15.0	30.0	23.2	15.0
Chinese Taipei	5.7	5.2	5.0	18.6	11.0	11.5
Thailand	33.9	27.7	13.9	46.4	27.6	11.3
United States	17.6	10.9	6.7	6.8	5.7	4.0
Average of All Countries	15.3	9.3	8.1	19.8	13.1	8.7
Average, Excluding US & Japan	16.0	9.4	8.4	21.1	13.8	8.9

Source: Pacific Economic Outlook.

through the outright abolition or conversion into tariff. To speed up the correction of the chronic discrimination against export, specific incentives were offered to exporters.

Investment policy constituted another important area of reforms. In 1986 Malaysia revised its Industrial Coordination Act, allowing a 100 per cent foreign equity. Far reaching reforms also took place in Indonesia. Though joint venture remained obligatory for foreign investment, the local equity requirement, the local content regulation, and the exclusion of foreign company from local trading, were all relaxed. In the case of both Indonesia and Malaysia, the industrial and trade policy reforms were patterned in such a way as to benefit, in the first place, export-related activities, implying a selective approach to reform. Nevertheless, the degree of opening reflected in the reforms was high enough to revive investors' interest in the two countries at a time when far-reaching changes were happening in the immediate surroundings of Southeast Asia, notably in the market-oriented economies of East Asia.

Thanks to the timely policy reforms and a highly favourable growth in the Pacific, the growth performance of the ASEAN countries had improved since 1987 and remained high in 1988. The prospect for 1990 is also perceived to be good as can be seen from Table 1 which is reproduced from the Pacific Economic Outlook. Investment has also been picking up, including foreign direct investment as can be seen from Table 6. The fear about the declining attractiveness of ASEAN as an investment location has not materialized, though one has to note hastily that this improved investment performance has been due partly to the necessity of investment relocation in Northeast Asia following

a rapidly increasing wages, currency appreciation and a worsened trade resistance in some of the major trading countries in the Pacific.

Of relevance to be noted here is also the restructuring in production and trade. Malaysia and Singapore and, to some extent also Thailand, have become major exporters of electronic and electrical products within the framework of the growing "global factory." Even Indonesia as the least industrialised among the ASEAN countries has managed to export a substantial amount of manufactured products such as textile and garments, plywood, furniture, footwear and iron and steel. In fact export of manufactured products has grown very rapidly in the last three years and currently accounts for a much larger proportion of Indonesia's total export, though one has to note here that this changed export composition is partly a result of the declined oil export.

Deteriorating balance of payments position was among the worries of ASEAN countries they entered the second half of the 1980s. However, ASEAN countries' score in this connection has also proved to be highly encouraging, thanks to the improved export performance and the substantial inflow of foreign investments, be they direct, portfolio or official developments assistance.

It is not the intention of this paper to draw a rosy picture about the immediate future of Southeast Asia. Notwithstanding the good performance in the last three years, the countries of Southeast Asia have still to cope with a variety of difficult problems. The fact that ASEAN countries are currently perceived to have a good potential of soon becoming part of the group of newly industrializing countries, is no reason for com-

placency. The viability of the economic recovery enjoyed by ASEAN countries in the last three years is dependent on the ability to cope with a wide range of issues. Some of them are domestic in origin while others are external in nature and they can only be addressed through international cooperation. Some issues have been there for quite a long time while others are completely new.

Domestic and Regional Issues

As mentioned earlier, foreign investment has been among the important ingredients of the economic recovery of the ASEAN countries in the last three years. Part of this investment is in the form of debt, both official and private. In other words, there is another side to the success story. External indebtedness is very high in some countries of Southeast Asia. At the end of 1988, Indonesia's external debt was estimated to amount to US\$55.6 billion, making it the largest debtor among the developing countries of Asia. The figure for the Philippines was US\$30 billion and for Thailand US\$22 billion. Debt servicing is a serious problem at least in Indonesia and the Philippines where the debt service ratio in 1988 was 40 per cent and 23 per cent respectively. While the debt relatively small, debt servicing is also a serious problem in these countries because of the very small and stagnant export. Part of the debt problems facing Southeast Asia has stemmed from the rapid appreciation of the yen which has denominated more than half of Indonesia's external debt, for example. Should there be another appreciation of the yen in the future, some countries in Southeast Asia would suffer further. In short, Southeast Asia is also facing a problem which afflicts

many developing countries as regards external indebtedness.

Another important economic issue facing Southeast Asia today relates to the serious problems of underdevelopment afflicting Myanmar, Kampuchea, Laos and Vietnam. In Myanmar and Vietnam live more than 100 million people. Growth rate in these countries has been discouragingly low in the last two years. It was in fact negative in Myanmar in 1988. The prospect for a strong improvement is also dim given the small investment which as a fraction of GDP, was as low as 10.5 per cent in Myanmar and 7 per cent in Vietnam in 1988 or far below the figures for ASEAN countries. These very weak growth and investment performances occurred at a time when inflation rate was exorbitantly high. Myanmar had to live with an inflation rate of 85 per cent in 1988 and Vietnam with an inflation rate of 308 per cent. This stagflation is difficult to cure, even within a country with a sufficient flexibility in its economic policy making, not to speak of a country with a mandatory planning. Admittedly, the socialist countries of Southeast Asia have embarked upon new economic policies or mechanisms in the last few years. Vietnam has done so, and so has Myanmar. The reform in these countries suffer from a serious ambivalence, however. The switch to a flexible economic management in the socialist countries of Southeast Asia has occurred only marginally. The effectiveness of the reform is further constrained by the lack of infrastructure. It will take a relatively long time before these two countries can cope with their present economic problems. In other words, Southeast Asia is likely to remain divided in terms of economic progress with ASEAN continuing its economic transformation at a rapid pace while

the rest of the region are lagging behind. Indeed, socialist economic system might have its last fortress in continental Southeast Asia.

Over the last ten years or so Southeast Asian regional politics has been dominated by the Kampuchean conflict. ASEAN has become, in a way a single issue association as far as regional politics is concerned without succeeding in bringing about the expected solution. The Kampuchean issues can no longer work as a glue between ASEAN countries. Instead, greater attention needs to be given to economic policy issues, if ASEAN is to remain in business in a world where economic cooperation clearly comes to the fore in the wake of a worldwide opening unprecedented in modern history.

Experience in the last ten years has shown that the Kampuchean conflict is basically immaterial as far as the economic development of ASEAN countries is concerned. Thailand which is often-time referred to as a "frontline state" has managed in fact to grow miraculously, precisely during this period. What is of direct relevance to future economic development of ASEAN countries is the ability to cope with domestic political issues such as succession which may affect the commitment to ASEAN cooperation. Of equal relevance is the emergence of a middle class of capitalists and professionals, who because of a strengthened economic position are likely to demand a quicker democratization process with all the institutional changes involved in such a process. Finally, ASEAN has to deal with security issues centred on the presence of extra regional powers in the region, the unavoidable increase in Japan's military posture and intra-regional cooperation.

Extra Regional Issues

Progress in transportation and telecommunication have literally created a global village where Southeast Asians can no longer isolate themselves from the influence of major events taking place elsewhere. In this connection, the question of global leadership ranks very high. While the United States is expected to continue to play the leadership role, its economic resources no longer allow it to engage in "benefaction" on a big scale which often-time is needed for an effective leadership. Japan, on the other hand, has a formidable economic strength but is obviously reluctant to assume the role of a leader partly because of self-imposed restraints, but also because of reluctance on other countries' side to follow Japanese leadership. Collective leadership sounds good. But the reality is that neither the G-7 mechanism nor the ASEAN external dialogue has proved effective. While the agenda of dialogue continue to lengthen, ability to agree on a coordinated policy is still lacking. This is of crucial importance to ASEAN countries with their increasingly open economies.

Currently, ASEAN and the rest of the wider Pacific are involved in the Uruguay Round. The issues addressed in this round are manifold, ranging from agricultural issues to intellectual property rights. By the end of 1990 it will be clear to what extent the GATT can continue to function as the pillar of the global trade regime. But in addition to the issues now being negotiated in the GATT, Southeast Asia still has to deal with other issues some of which are old, but some others are completely new.

Among the old issues which are of relevance to Southeast Asia is the debt issue,

Table 3

SHARES OF SELECTED REGIONS IN WORLD TRADE AND OUTPUT

	Share of World Trade Per Cent		Share of World Output ^a Per Cent	
	1967	1987	1967	1987
North America	20	18	30	26
Japan	5	8	5	13
Other				
Asia Pacific Region	8	12	4	5
Total				
Asia Pacific Region	33	39	39	44
EC ^b	39	40	18	23

^aIncludes World Bank non-member, non-reporting countries, such as the USSR^bAs now constituted

Table 4

WORLD TRADE VOLUMES, 1980-88^a
(Annual Changes, Per Cent)

	Average 1980-88	1980	1981	1982	1983	1984	1985	1986	1987	1988
World	3.2	1.3	1.2	-1.8	2.7	8.6	2.9	4.5	6.5	8.9
Industrialised Countries	4.6	1.4	1.1	-1.3	3.8	11.1	4.7	5.6	6.4	9.2
Asia-Pacific Region ^{c,d}	6.4	2.6	2.3	0.9	6.4	11.7	4.0	7.5	9.6	13.1
Industrialised Countries	5.0	0.6	0.5	0.4	4.6	12.1	4.9	5.7	6.3	10.7
NIEs	11.6	9.8	9.0	1.5	13.1	13.7	2.3	15.9	23.1	17.7
Other ASEAN	7.4	5.7	3.6	5.6	8.0	-1.3	-1.7	3.0	8.4	40.3 ^e

Sources: IMF World Economic Outlook, October 1989 and International Financial Statistics, Yearbook 1988; World Bank 'World Tables', 1988-89; and Asian Development Bank 'Key Indicators', July 1989.

^aAverages of growth rates for exports and imports^bCompound annual rates of change^cExcluding China and Brunei^dGroupings weighted by 1987 merchandise trade^eIncludes only imports data for the Philippines and exports data for the Philippines and Malaysia

given the high debt burden in some countries in ASEAN and the rest of Southeast Asia. Should the decline in commodity prices persist and a demand contraction occur in the United States, Indonesia and the Philippines may find their respective debt burden too high to be honoured according to schedule. The question of debt relief may then arise as a burning issue. Japan may be asked to take a more accommodative stance. Of course, the best solution to debt problems is a rapidly expanding export. Therefore, improvement in the trading environment should be given the highest priority.

Economic restructuring has been going on in Asia since at least 1985. Rising labour costs, currency appreciation and increased resistance to trade in some of the major trading countries in the Pacific have forced Japan and the rest of Northeast Asia to relocate some production to the rest of the world, including ASEAN. To sustain this restructuring, however, new investments in infrastructure are needed. Complaints about bottlenecks have been expressed already. Yet, the host countries are confronted with resource constraints which cannot be overcome unless a sustainable inflow of ODA is secured. Herein comes Japan again to the fore.

Finally, the 1990s are likely to witness a closer and closer linkage between environmental and trade policy issues. While in the 1980s trade-related investment measures (TRIM) and trade-related intellectual property issues (TRIP) were introduced into the agenda of trade negotiations, we may soon have to deal also with trade-related environmental measures (TREM). Southeast Asia is bound to be affected by such a development, given its tropical forest resources and the importance of these resources to the economic development of the region.

Greater Demand for Institutionalization of Pacific Cooperation

The evolution of Pacific Economic Cooperation in the 1970s and 1980s was largely shaped by a greater frequency of meetings sponsored by non-governmental organization on an increasingly wider range of issues. There is no need here to discuss again the formation of the different organizations as it has been thoroughly studied elsewhere. The following discussion is centred on recent developments in the process of institutionalization and the main controversies involved therein.

The Pacific Economic Cooperation Conference (PECC) which started in Canberra in 1980, deserves to be singled out among the different routes to institutionalization of cooperation among the Pacific countries. It has the widest participation in terms of countries participating in the process. It is also unique because of its tripartite structure, involving government officials, businessmen and members of the academic community in its activities and organizational machinery. Whether one talks about the Standing Committee (SC) as the highest body of decision making in the PECC process, or the National Committee (NC) which functions as the highest decision making body in each of the member countries, or the Task Forces (TF) which serve as research arms of the SC, a tripartite participation at the highest possible level of participation is sought. Through this tripartite mechanism, the findings of Task Forces and General Meetings, in the form of conclusions and policy recommendations, are directly transmitted to interested government agencies with the obvious aim of providing them with richer inputs while formulation economic policies.

Table 5

TRADE DEPENDENCE ON ASIA-PACIFIC

	Share of Exports Going To Asia-Pacific Economies (%)		Share of Imports Coming To Asia-Pacific Economies (%)		Share of Trade with Asia-Pacific Economies (%)	
	1978	1988	1978	1988	1978	1988
Japan	55	67	51	63	53	65
China	56	70	50	65	53	67
NIEs	65	73	70	75	67	74
Other ASEAN	75	75	66	69	71	72
North America	47	59	51	62	49	61
Australia/New Zealand	63	68	57	66	60	67
Total Asia-Pacific	54	66	54	65	54	65

Table 6

INVESTMENT IN THE ASIA-PACIFIC

	Capital Transactions 1988 (million \$)	
	Direct Investment	Portfolio Investment
Australia	-303	5,240
Canada	-3,320	10,328
China (1987)	1,669	1,191
Indonesia	542	-134
Japan	-34,630	-53,230
Korea	720	-482
Malaysia	611	-966
New Zealand (1987)	104	-
Philippines	936	50
Singapore	1,066	135
Thailand (1987)	182	346
United States	21,810	41,110

PECC is also important to be singled out in terms of the issues it has so far addressed. They include agriculture, mineral and energy, forestry, fishery, human resources, science and technology, transportation, telecommunication and tourism and many others. In each of the issue areas, the sharing of information, promotion of investment and trade as well as functional forms of co-operation such as policy dialogue and possible coordination and technical projects such as tuna tagging, are addressed simultaneously. There is clearly a proliferation of Task Force meetings. The speed is widely perceived to have been too fast in terms of the ability of PECC to organize its activities and to communicate in an effective way the results of its numerous meetings to the governments.

One of the most important contribution of PECC to the development of Pacific co-operation is the increased awareness among people all over the globe of the strong and rapidly strengthening interdependence among the economies of the Pacific. At the same time it is also increasingly recognized that this increased interdependence does also have unpleasant sides as reflected among others in the trade frictions which also have tended to concentrate in the Pacific in the last decade. The "fair trade campaign" of the United States is a clear example. It was fought with particular intensity in the Western Pacific. Yet, it is clear even to many Americans that bilateral campaign is bound to fail in a truly interdependent world. The ineffectiveness of the campaign also provides good reason to believe that trade, today, is affected by an increasingly wider range of policy measures of which protectionism may no longer represent the most important one. In fact, the resistance of trade to protectionist measures seems to have greatly improved thanks to the prolife-

ration of global factory in growing industries such as information industry where interdependence among firms is a dominating feature.

At the end of its first decade of existence, PECC was widely criticized of being too academic. It was accused of having offered too little to the business community and governments. This criticism led to institutional reform within the PECC. Following the recommendations of an ad-hoc Task Force on institutional reform, the Seventh General Meeting of PECC, convened in Auckland in November 1989, agreed to establish a Permanent Secretariat and to streamline the operation of the different elements of the PECC machinery. Outside PECC, however, people have become impatient about the slow progress in the institutionalization of Pacific economic cooperation.

In January 1989, the Prime Minister of Australia, Bob Hawke, proposed in Seoul the formation of an inter-governmental forum with an open ended proposal on its formal structure. Similar pressure also came from Japan's Ministry of Trade and Industry (MITI). This demand for an inter-governmental forum is shared by many governments, though the terms of reference seem to differ from one government to the other. In general, nobody has so far proposed the formation of an exclusive trading block. Instead, the forum is often-time conceived as a vehicle to push progress in the ongoing Uruguay Round of Multilateral Trade Negotiation. This open-ended term of reference is clearly reflected in the first APEC (Asia Pacific Economic Conference), convened in Canberra just before the Auckland General Meeting of PECC.

When the idea of an intergovernmental forum for Pacific cooperation was floated in early 1989, ASEAN countries reminded

governments in the region of the ASEAN Post Ministerial Conference (PMC) which was launched in 1984 as a two-tier forum for Pacific cooperation. The first tier consisted of project cooperation which at that time took Human Resources Development as a pilot project. The second tier was supposed to be in the form of policy dialogue, but has never really got off the ground. In fact, the PMC is defective in many respects if it is to function as a Pacific-wide forum for cooperation.

When ASEAN governments tried with different degree of enthusiasm to revive the PMC, responses from other countries were mixed. It is certainly still alive among the various routes to the institutionalization of Pacific cooperation. Indeed, it seems important for Southeast Asians to work together in such a way as to make the PMC route more attractive to the whole Southeast Asia itself and to the rest of the Pacific. Reforms are needed in the PMC in respect to its country coverage, issue coverage and organizational machinery, if it is to be respected as a viable route to Pacific economic cooperation. In doing so, governments in Southeast Asia in general and in ASEAN in particular have to be realistic as to the niche they can occupy in the shaping of Pacific economic cooperation. The institutionalization of this cooperation will proceed further irrespective of whether or not Southeast Asia is involved in it.

Strategies of Participation in the Wider Pacific

We have surveyed in earlier sections the issues which are of relevance to future development, especially economic development, of Southeast Asia. In essence, the ob-

jective of Southeast Asia's participation in the wider Pacific should aim at the restoration of the open trading system. Given the policy adjustment undertaken in the second half of the 1980s not only by ASEAN countries, but also by Myanmar, Laos and Vietnam, an open trading system has become a basic need for Southeast Asian prosperity. On the other hand, Southeast Asian countries are all small countries seen from the viewpoint of international trade, if they act individually. Even as a group, Southeast Asia controls only a small part of the Pacific trade. The fact that ASEAN has managed to become an important entity in the Pacific is not proportionally related to its trade importance. It is the realization that ASEAN has somehow helped to mediate between the Third World and the developed world in respect to diverse issues of economic relations that gives ASEAN a weight which is greater than warranted by its economic importance.

So far, ASEAN countries have worked together very closely whenever a position on an important issue of Pacific cooperation needs to be taken. Such a close cooperation has made it possible for Southeast Asians to play a role in the shaping of Pacific cooperation. It is this cooperation that brings the Permanent Secretariat of PECC to one of the ASEAN countries, namely Singapore. It will also be cooperation among ASEAN that will determine to a very large extent whether or not this Permanent Secretariat can help to draw greater and greater attention of the Pacific to the concerns of Southeast Asia.

Similarly, ASEAN governments also worked together while preparing themselves for the first APEC in Canberra. It is important to note in this connection that ASEAN countries have managed to suppress national

ego in favour of a common position. With all its shortcomings, the ASEAN PMC remains alive as a possible route to the institutionalization of a Pacific-wide cooperation. ASEAN countries are now challenged to come with a more concrete idea in preparation for the next APEC which will be held in Singapore.

Experiences so far tell that ASEAN countries will be better off if they enter the Pacific through ASEAN rather than individually. To be credible, however, ASEAN has to be flexible in reforming its organization as to be more sensitive to the common concerns of the wider Pacific. First of all, to be effective, improvement in ASEAN machinery is necessary. ASEAN Secretariat needs to be given at least a capability to do research and to work out working papers which may be needed by governments. Economic ministers need to be given a greater role in the shaping of the relations between ASEAN and the wider Pacific. No one can deny that the primary concern of the Pacific

today -- this in fact applies to the whole world -- is economic in nature. Secondly, the same flexibility is required in respect of the country coverage of any ASEAN-based mechanism. In this connection the sectoral dialogue with South Korea is a positive step. Finally, ASEAN countries can no longer afford to have a single issue dialogue if it is to be respected in the wider Pacific. The extent to which ASEAN can play an active role in the shaping of Pacific cooperation depends to a very large extent on its ability to address economic policy issues which currently pre-occupy the majority of the Pacific countries. A successful completion of the Uruguay Round needs, obviously, to be given the highest priority. But other issues are also waiting to be addressed. Therefore, ASEAN is facing the challenge of having to work out proposals on each of these issues. So far, ASEAN's performance is good as long as the proposal remains at a high level of generality. What is needed for the time being is, however, concrete proposals on a wide range of pertinent issues.

The Role of PECC in the 1990s and Pacific Institutions

Jusuf WANANDI

Introduction

IN DISCUSSING the role of PECC in the 1990s, I like to make two assumptions at the outset. The first assumption is that the rationale and case for Pacific economic cooperation are already widely known and accepted and that they remain valid until today. The second assumption is that the underlying factors and considerations which led to the formulation of the so-called "Canberra process" -- as manifested in and by PECC -- are well understood and appreciated and remain equally valid to this day. The objectives, premises, and structure of Pacific economic cooperation so conceived have been clearly defined in the so-called Vancouver Statement on Pacific Economic Cooperation.

It also should be noted here that during the past nine to ten years since the beginning

Paper presented at the Pacific Economic Cooperation Conference (PECC) VII, Auckland, 12-15 November 1989.

of the process the region has seen a remarkable socialization of the idea of Pacific economic cooperation. Until not long ago, the idea was entertained within very limited circles only. The ongoing activities of PECC, together with those of PAFTAD and PBEC, have resulted in an ever growing number of promoters and supporters of the idea. Interest in Pacific economic cooperation has expanded to a wider range of countries and economies. The People's Republic of China is now an active participant in PECC; a number of Latin American countries, namely Mexico, Peru and Chile, have stated their interest to become members of PECC.

PECC itself has initiated and undertaken a host of relevant region-oriented studies, it has organized regular regional seminars and fora on specific policy issues and in various fields, and most importantly it has greatly facilitated the promotion of mutual understanding and personal acquaintances. However, it is generally felt that the involvement of governments in the tripartite nature of

PECC activities has not been satisfactory. There are two views on this subject. The first view is that the tripartite nature of PECC is not only a desirable feature of cooperation in the Pacific but also a necessary one. Thus a priority item in PECC's agenda should be the strengthening of governments' involvement in it. The second view is that the only effective means of cooperation in the Pacific is an intergovernmental regional organization and that the tripartite, non-governmental PECC is only a stop-gap measure; PECC is temporarily accepted as the only politically feasible arrangement under current circumstances.

It is perhaps of less relevance here to examine which of the two views is the more prevalent one. It is interesting to note, however, that currently there is a resurgence of attempts and initiatives to promote the development of Pacific-wide intergovernmental cooperation and institutions. Although all such initiatives have failed in the past, perhaps there is greater possibility today that an intergovernmental process can take place and that this may lead to the setting up of an intergovernmental Pacific regional organization.

I will briefly review the recent proposals for such intergovernmental regional initiatives and will suggest the factors that appear to be critical to their realization. This will be followed by an examination of the crucial role that PECC will play as such intergovernmental processes are undertaken. In fact, there is a strong rationale for continuing to strengthen PECC even when these formal processes have resulted in the establishment of an intergovernmental regional institution.

Proposed Pacific Institutions

Since its general meeting in May 1988 in Osaka, PECC VI, attention has been given to the subject of PECC institutional development and greater involvement by governments in PECC activities. It has been agreed in general that PECC's main tasks would be to enhance its role through expanding its activities while focusing them more sharply on issues of relevance to governments in the region.

The PECC Ad Hoc Task Force on Institutional Reform which examined the above issues also discussed the possibility that PECC could sponsor or provide a venue for the organization of an informal high-level meeting of economic ministers from PECC members. Such a meeting could focus on global trade problems affecting the region, the outlook for the Pacific economies and issues of economic structural adjustments, relevant sectoral issues, such as minerals and energy, agriculture and fisheries, as well as other important problems which PECC has begun to look into, namely science and technology as well as transportation, telecommunication and tourism (the so-called Triple-T). This idea does not seem remote in view of the fact that an independent organization based in London, the Trade Policy Research Centre (TPRC), has successfully convened regular Asia-Pacific meetings involving ministers and other high-level officials, the latest being held in Bali in January 1988. Given its tripartite format and its wider geographic coverage, PECC definitely has an advantage in convening a meeting that has a wider scope than that of the TPRC-sponsored meetings.

While deliberations on such possibilities are undertaken within PECC, the Australian

Prime Minister, Robert Hawke, proposed in his trip to Seoul in January 1989 the desirability of more formal consultative arrangements on economic matters and suggested that the form such arrangements might take could be jointly examined at a high-level meeting. In Mr. Hawke's view, any such arrangements should complement rather than replace the existing consultative arrangements in the region, i.e. PECC.

During the past two years similar ideas and proposals have been launched again. The earlier wave of such proposals took place in the late 1960s and early 1970s. There were a variety of reasons why even the more serious attempts failed. It seems that the success of the PECC process has given a new stimulus to the idea of an intergovernmental Pacific regional organization. However, there were also views suggesting that PECC itself has already reached the limits of what it can do and that further progress in Pacific economic cooperation will have to rest on intergovernmental mechanisms.

In this latest wave of proposals, ideas were aired by then Prime Minister Nakasone of Japan in the Second Ellsworth Bunker Memorial Lecture in San Francisco in March 1988, which he reiterated at the opening of PECC VI in Osaka. Nakasone did not explicitly propose the setting up of an intergovernmental institution. His proposed forum, to be called the "Pacific Forum for Economic and Cultural Cooperation," was aimed at the promotion of free economic, cultural and information exchange. However, he further suggested that this forum could take the form of a Pacific OECD on cooperative activities, consisting of all developed and developing countries who may wish to participate. By implication, this forum will be an intergovernmental one.

George Shultz, in his speech in Jakarta in July 1988 during his final Asian journey as US Secretary of State, proposed a similar forum. Although he was not specific about the nature or membership of a new intergovernmental Pacific regional body, he described such a forum as one where like-minded countries could compare experiences, discuss ideas and prepare analyses on subjects that are of interest to most countries in the region. In December 1988, a US Senator, Bill Bradley from New Jersey, called for the setting up of a Pacific Coalition. He was inspired by the example of the Group of Seven industrial countries, but proposed that initially this Coalition should be small and should include the largest GATT members in the Pacific that are committed to strengthening the multilateral system, with equal numbers of developing and industrial countries. Its main task should be to address the main threats to the region's economic security. Specifically, the Coalition's mission should be threefold, namely: (a) to reinforce the Uruguay Round by building consensus on trade issues; (b) to ensure greater economic policy coordination among the countries around the Pacific rim; and (c) to remove obstacles to developing countries growth.

In April 1989, another US Senator, Alan Cranston from California, proposed to the US President to take the lead in the establishment of a Pacific Basin Forum in the form of annual summits with leaders from other nations in the Pacific rim to discuss both economic and regional security issues. In September 1989 the Subcommittee on Asia and Pacific Affairs in the Senate, chaired by Cranston, began a series of hearings on the proposal.

Of the many ideas launched and pro-

posals made by government leaders and politicians, only Mr. Hawke's has been seriously pursued. Initially, his idea was received with great scepticism. His reference to the OECD model was interpreted as a proposal for the creation of a Pacific OECD, comprising Western Pacific countries. Suggestions were made that Hawke's idea of organizing a grouping of Western Pacific countries was largely in reaction and was meant to provide a counter, to both the European Community and US trade policies, especially in the field of agriculture. Subsequently, however, the Australian Prime Minister invited the United States and Canada to participate in his proposed intergovernmental vehicle of regional cooperation. Indeed, any Pacific regional consultative arrangements would be meaningless without the participation of the United States, whose economy is so closely intertwined with other Pacific economies.

In its preparation to organize and host the proposed meeting, the Australian government has sent an envoy, Ambassador R. Woolcott, around the region. It became clear during the visits to most Pacific capitals that even a preliminary discussion of the institutional aspect of intergovernmental cooperation in the Pacific is too premature. ASEAN governments agreed to participate in the proposed meeting but they were far from sure whether institutional issues should be put in the agenda.

Japan's position on the issue of Pacific institutions was made clear both in the visit by PM Takeshita to the ASEAN region in May 1989 and in the ASEAN Post Ministerial Conference (PMC) in Brunei in July 1989. Its position is that Japan will support the establishment of any Pacific regional organization that has ASEAN's support. US Secretary of State, James Baker, made a

similar statement in Brunei. Australia has also made it clear in Brunei that it is not advocating a particular arrangement and that it is open for suggestions. Agreement was also reached to confine the meeting to the five Pacific OECD countries, the six ASEAN countries and the Republic of Korea. Thus, the stage was set for the high-level meeting to take place on November 6 and 7, 1989 in Canberra.

In mid-September a Senior Officials Meeting (SOM) of invited countries was convened in Canberra to prepare the agenda for the high-level meeting. PECC was asked to submit substantive inputs to the meeting and its Standing Committee responded by preparing written reports on the results of PECC fora and task forces. The SOM meeting also agreed to invite the Chairman of PECC's Standing Committee, together with the Secretary General of ASEAN and representative of the Pacific Forum to participate in the high-level meeting.

An ASEAN-based Mechanism?

In response to Mr. Hawke's proposal there have been renewed discussions in ASEAN on the issue of Pacific economic cooperation. The first discussion took place at the ASEAN Ministerial Meeting (AMM) and the ASEAN Post Ministerial Conference (PMC) in Brunei in July 1989. This was followed by a discussion in the meeting of ASEAN Economic Ministers in Bangkok in September 1989. ASEAN has first taken up this issue in 1984 when the then Chairman of the ASEAN Standing Committee, Minister Mochtar Kusumaatmadja of Indonesia, proposed the initiation of the so-called ASEAN-Pacific Cooperation (APC).

ASEAN has concluded for some time now that greater consultation and cooperation among Pacific economies would be useful for the region as a whole as well as for its individual countries. The reasons have become clear as the international division of labour in the Pacific region continues to develop so dynamically. Figures can speak for themselves. ASEAN's external economic relations are predominantly with other Pacific economies. Thus the ASEAN economies have become highly interdependent with their main economic partners in the Pacific. But interdependence is not without problems. The region does need some kind of a consultative forum in order to manage this interdependence. From ASEAN's perspective, economic relations and economic cooperation have become matters of first priority.

It was definitely with this consideration in mind that ASEAN foreign and economic ministers agreed to attend the Canberra meeting. But ASEAN has also made it clear in Brunei that at least the following two conditions need to be fulfilled for the Hawke's initiative to be successful. It should be noted that the success of the initiative will not be measured simply by whether a high-level meeting takes place or not.

The first condition relates to the principles of cooperation, and the following six points have been put on the table for some time:

- Pacific economic cooperation should be based on independence, mutual respect and equality;
- It should complement ASEAN's regional activities and role in the Pacific, and should strengthen multilateral mechanisms for cooperation, particularly the GATT;
- It should not lead to the creation of an economic bloc or an exclusive trading arrangement;
- It should be developed in a gradual fashion and be properly planned;
- Its objective should be to increase the welfare of the peoples in the Pacific region and to reduce the gap between the developed countries and the developing countries in the region;
- It should contribute to the creation and maintenance of a stable and open trading system -- regionally and globally -- and a regional environment which is conducive to the promotion of mutual interests, including the ability to resolve regional conflicts peacefully.

The second condition relates to the creation of intergovernmental institutions or mechanisms for regional cooperation. The processes involved in the development of Pacific institutions are essentially political in nature. They also take time to materialize. Therefore, ASEAN has offered its institution to be used at this stage as the basis for Pacific intergovernmental consultations.

There is the view in ASEAN that the ASEAN PMC, which already includes Australia, Canada, Japan, New Zealand, and the US, can suitably perform this function if some adjustments are made. Another suggestion is to develop a broadened AEM meeting or to combine the ASEAN PMC and the AEM in the form of a council of ministers meeting as the mechanism for Pacific dialogue and consultations.

Adjustments in the ASEAN PMC as referred to above would include the following steps. First, participation in the PMC needs to be extended. The Republic of Korea is the most immediate candidate. The Pacific

Island Nations should also be represented, at least through the South Pacific Forum. The EC could also be invited as an observer, contingent upon its future development in relation to 1992. The interests of other Pacific economies can be represented in this forum temporarily through PECC which has wider membership to include representation from both China and Chinese Taipei.

Second, the PMC's agenda need to be broadened to include trade policy issues, issues of macroeconomic policy coordination and structural adjustments, while technical cooperation issues should be dealt with in a lower level forum. Third, the format of the PMC should be made more multi-lateral. This means that the series of "6 plus 1" meetings of the ASEAN six with individual dialogue partners should no longer be of the same importance they are accorded to currently. Instead, the forum for consultation should be focused on the extended "6 plus 6" meeting.

Fourth, since institutionalization of Pacific economic cooperation is essentially political in nature, and in view of the fact that the agenda for consultation will be heavily focused on economic matters, the "reformed" PMC should involve both foreign and economic ministers. Such is also the case with OECD meetings. In addition, a joint meeting of senior officials from foreign and economic ministries should also be formed. Fifth, the ASEAN Secretariat needs to be strengthened, in terms of both its capabilities to provide secretarial services and improved analytical capabilities.

Sixth, the reformed PMC also needs strong research support but it does not have to establish its own research arm. Instead, it can rely on existing institutions in the region which have already established an effective

network among themselves. One such institution is the ASEAN ISIS (Institutes for Strategic and International Studies), an ASEAN recognized non-governmental association. The other relevant institution which has developed an even much more extensive communication and research network throughout the Pacific is PECC. This reformed PMC mechanism could establish formal linkages with PECC in the same fashion ASEAN has developed links with the ASEAN CCI (Chambers of Commerce and Industry). This linkage could provide communication channels for other economies in the Pacific -- particularly members of PECC which are not included in the PMC -- with this new consultative mechanism.

Apart from ideas and an existing mechanism that ASEAN has to offer, it appears that ASEAN has a political will to begin to engage in intergovernmental processes towards the realization of the idea of Pacific economic cooperation. This is definitely a significant change from ASEAN's previous posture which has been one of the main obstacles in pursuing previous initiatives. ASEAN was very reluctant and cautious to the idea because of the fear that a Pacific cooperation framework would be dominated by the developed countries.

There are a number of developments that have favourably influenced ASEAN's attitude. One important factor, as mentioned before, is that over the past 10 years or so there has been a gradual process of socialization of the idea of Pacific economic cooperation within each of the ASEAN countries. The regional environment itself has made the case for cooperation more logical. In addition, the many activities of PECC and its member committees, as well as PBEC and PAFTAD, have greatly increased both

the relevance and visibility of the "movement."

Nonetheless, confidence on the part of the ASEAN countries in their ability to play a part in the process of cooperation largely depends on the institutional setup of the new regional mechanism. An ASEAN-based mechanism would greatly reduce ASEAN's anxieties. This was Minister Mochtar Kusumaatmadja's point when he initiated the establishment of the ASEAN-Pacific Cooperation (APC) mentioned previously. In fact, at the PMC of the 17th ASEAN Ministerial Meeting in Jakarta in July 1984, agreement was reached between ASEAN and its Pacific dialogue partners to initiate the APC which was based on a two-tier approach: (1) to exchange views on the general economic trends and developments in the Pacific region; and (2) to identify and develop specific areas for possible cooperation in the region. For the initial period, it was agreed that cooperation should focus on human resources development (HRD) programs. It was unfortunate that the APC did not really get off the ground because of a lack of support from some ASEAN members. But in 1988 ASEAN members made a new commitment to implement the HRD programs.

The above examination suggests why an ASEAN-based mechanism should be seriously considered as a viable option for the development of an intergovernmental Pacific consultative arrangement. There is still the question of how to accommodate the interest of China or Hong Kong or Chinese Taipei to participate directly in this mechanism. It is not clear whether an agreement on such an ASEAN-based mechanism can immediately be reached. But any other intergovernmental arrangements have an even smaller chance of being accepted by some, if not all, ASEAN countries.

The other viable option for the region is a PECC-sponsored high-level consultative forum, which is less formal in nature but can still be effective. PECC could be encouraged to prepare meetings which would involve ministers and other senior officials, and such meetings could also be attended by business representatives and academics as resource persons. Such meetings can be tailored to the specific needs of the governments in the region as may be identified by officials participating in PECC.

To sum up this discussion, the following compares the positive and negative factors -- or the advantages or disadvantages -- of each of the two options described above. An ASEAN-based institution has the advantage that it is a formal, intergovernmental institution. Its influence upon government policies are more direct, more immediate, and perhaps more effective. In addition, it can develop into a full-fledged intergovernmental organization representing the entire region. It should be emphasized here that such an ASEAN-based mechanism should be seen as a temporary institutional arrangement, but as the only intergovernmental forum which is acceptable to ASEAN governments at this stage.

The main disadvantage of this mechanism is that its participants tend to be limited to the 12 countries, the five Pacific OECD countries, the Republic of Korea and the six ASEAN countries. Another disadvantage is limited research capabilities. Also, its temporary nature tends to reduce its influence on and authority in government policy formulations.

However, some of the above disadvantages could be remedied through the establishment of some linkages with PECC. As suggested earlier, PECC can usefully func-

tion as a channel for the interests of other countries or economies in the region that are not taking part in this mechanism, notably China, Hong Kong and Chinese Taipei. PECC can also become a main source of studies on regional economic issues for the intergovernmental consultative process.

In contrast, a PECC-sponsored high-level meeting has the following advantages: it has wider participation, including China and Chinese Taipei; it has the mechanism to generate relevant research and has developed a regional networking that has been tested; and perhaps most importantly, its informal and tripartite nature allows PECC to be flexible and very responsive to changes and developments in the region. PECC's advantages, however, could well be seen as its disadvantages. Its informal nature creates doubts about its effectiveness in influencing government policies. Similarly, its tripartite nature could be a source of problem since government officials may feel more constrained than non-government participants in proposing or endorsing policies even though they are present in their individual capacity. In addition, processes within PECC tend to be slow because of its very nature.

The Role of PECC

The preceding discussion suggests that in either of the above two viable options, PECC is expected to play an important role. Therefore, its main task today is to strengthen its institutional arrangement. Its importance has been recognized in PECC VI in Osaka which led to the establishment of the Ad Hoc Task Force on Institutional Reform. The report of this Task Force identifies three main tasks:

1. Further strengthening of Member Committees, since it is recognized that the Member Committees are the backbone of PECC activities;
2. Further development and strengthening of relations with:
 - (a) governments which have the real authority to make decisions to promote regional cooperation; the key to increased government participation in PECC lies in the relevance of PECC to the respective governments;
 - (b) the business community who are also the real players in the region's economic scene; greater involvement by the business sector in PECC depends upon the latter's ability to formulate action-oriented activities as well;
 - (c) other regional and international organization such as the ADB, ESCAP, ASEAN, SPF, in addition to PBEC and PAFTAD, as well as OECD, GATT, IBRD, IMF, UNCTAD, and IEA.
3. Further institutionalization of PECC, which includes the following proposals:
 - (a) to establish a permanent but small Secretariat (in Singapore);
 - (b) to clearly define the task and mandate of the Coordinating Group in assisting the Standing Committee, especially in regard to evaluating the work of the various PECC fora and task forces as well as in the initiation of new task forces or study groups;
 - (c) to improve the institutional structure of task forces (and fora or working groups) through the introduction of an international advisory group and a small secretariat to assist the work and operation of each task force;

- (d) to enhance PECC's public relations and communication, both internally and externally, among other things through the publication of a newsletter.

It is generally understood that with the above institutional improvements and an improved management of the existing policy oriented fora and task forces, and the establishment of well focused task forces, such as on Science and Technology, and the Triple-T (Transportation, Telecommunication, and Tourism), PECC's relevance to the region will be further increased. In spite of all this, however, there is a question that can legitimately be raised and which needs to be addressed, namely whether indeed there is still a role for PECC if an intergovernmental regional organization for the Pacific is it to set up.

If the view is correct that by default PECC's tripartite process develops because governments were not ready to engage in a formal regional cooperation arrangement, then it is logical that PECC will no longer be relevant as soon as an intergovernmental institution is established. Does it make sense for PECC, whose activities essentially rest on private or individual resources, to extend support to such an intergovernmental institution? In addition, would it be realistic to expect that governments would want to rely on and make use of studies and other inputs provided by PECC? Would they not prefer to set up their own "in-house" study or research capabilities, or to relate directly to PBEC or PAFTAD?

Given the diversity and heterogeneity of the region, it is hard to imagine that an intergovernmental institution in the Pacific could function smoothly, especially in its early years. Its development will also be very slow

if political and other sensitivities are properly taken into consideration. In addition, developments in the region are likely to continue to be as dynamic as in the recent past so that no single intergovernmental institution can adequately accommodate and effectively deal with the many emerging new regional issues and problems. Thus, the role PECC is playing today -- albeit still limited -- cannot be substituted by any intergovernmental institution.

This, in fact, has been the wisdom that led to a recognition of the desirability of tripartitism. When the Canberra process was launched in 1980, its non-formal, tripartite structure was not seen as a stop-gap measure or made in preparation for the establishment of a full-fledged intergovernmental organization. Insight and realism suggest the necessity and desirability of this process. The strengths and advantages of PECC cannot be substituted by an intergovernmental institution. Thus even though an intergovernmental organization might emerge, PECC's unique role remains relevant into the future.

As suggested earlier, the process of intergovernmental institution building in the Pacific is likely to be a very slow process. Therefore, it needs continuous stimulus from the outside. PECC can play such a role while at the same time contribute to the further socialization of the idea throughout this vast and diverse region. Given the dynamic developments in the region, there is the need to continuously identify new areas of regional relevance and concern. It is likely that PECC could adequately respond to this challenge. In addition, and ultimately, there is the "old" political problem of membership in any intergovernmental organization that cannot easily be dealt with in this diverse and heterogeneous region. Non-

governmental institutions can more readily cope with this issue. After PECC has further strengthened its institution, along the lines suggested by the Ad Hoc Task Force, it will be more ready to expand its membership to include, for instance, a number of Latin American countries. There is also the challenge for PECC to bring in the Soviet Union.

Indeed, PECC's constructive role in the future will be guaranteed if it maintains openness in terms of membership as stipulated in the Vancouver Statement, subject to the following criteria: that members are free and open economies, that they participate in the region's economy in a substantial

way, and that they actively participate in PECC activities.

There are a host of other challenges for PECC in the 1990s. How can PECC increase the weight and relevance of its studies and recommendations? In addition to the areas of interest and expertise that PECC has developed over the years and the more recent subjects of science and technology, the Triple-T, and environmental matters, can PECC contribute to an improved understanding and discussion of monetary and financial matters, commodity issues and the interests of the developing countries, both from a regional and international perspectives.

Japan's Role in the Asia-Pacific Region: An ASEAN Perception

A. Hasnan HABIB

Introduction

THE POST-WORLD WAR II years have witnessed a truly remarkable phenomenon, viz. the rise of a nation from defeat and ruins to an economic superpower, and that an Asian nation. Japan has become the economic success story of the century, a story of continuous economic growth. Yet, she is still surging forward, exploiting the world's resources, producing and selling to the world in the single-minded pursuit of profit and evergrowing GNP.

Many foresee Japan becoming a 21st century economic and financial superpower ahead of any other industrial nations, including the United States. Of the world's ten largest banks, nine are Japanese; based on the size of deposit, no US bank makes it into the top 25. Japanese households save an average of 17 per cent to 19 per cent of their

annual income, while American households save less than 5 per cent.¹ The US has become the largest debtor country, whereas Japan the largest creditor nation. It is estimated that the American external debt balance will expand from US\$400 billion at the end of 1987 to US\$800 billion by the end of this decade, while Japan has an external credit balance growing from US\$240 billion in 1987 to US\$400 billion by the early 1990s. This year Japan will also surpass the US as the world's largest foreign-aid donor.

Since the end of World War II, Japan has been the fastest-growing global economic power, evidence of her super economic management, national discipline, work ethics, and strong commitment to economic growth, her one single national goal. The economy grew at an annual rate of 4.3 per cent from 1965 to 1986, higher than the 2.3 per cent average for all the industrial countries of the world. But at the same time

Paper presented at the Fifth ASEAN-US Conference, Singapore, 11-16 June 1989 organised by CSIS, IEAS (California) and SIIA (Singapore).

¹R. Taggart Murphy, "Power Without Purpose: The Crisis of Japan's Global Financial Dominance." *Harvard Business Review*, March-April 1989.

she has also been the most insular, isolated from foreign economic penetration.

Japan's vast economic strength, organizational skills, superior technology, expanding global economic and financial interests, and rising international standing on the one hand, her increasing dependence on natural resources and markets on the other, raise many questions concerning her international and regional role. Can the world's largest creditor continue to enjoy a "free ride" at the expense of the world's largest debtor? How and what should be her share of the cost of defending the "free world"? Does he aspire to become a great military power? Since she has become an economic superpower shouldn't she play a concomitant role in other fields? How will her relationship develop with the US as well as with the other countries in the region? Does "burdensharing" insisted upon by the US, also imply division of responsibility as well as joint decision making?

These are questions which have been incessantly written about, debated, and discussed at numerous seminars and conferences. For many Japanese those questions have been perplexing, moreover now that big changes have taken place since the last 3-4 years requiring adjustments by all nations, particularly major ones, to the effects of these changes.

The destiny of Japan is tied to a large extent to that of the countries in this region. Virtually every one of these countries finds Japan either its first- or second-largest trading partner, foreign investor and foreign-aid donor. Japanese trade, investment, aid, and technology have largely been the engine of the economic dynamism of the region.

This paper is not an attempt at assigning nor prescribing what that role should be. That should be determined largely by the Japanese people themselves. However, in this increasingly interdependent world, no nation can set a course in foreign affairs in a vacuum. All nations, regardless of size, strength and power, are now exposed to many forces and processes, often beyond their control. Decisions on economic, political and security policies taken in one country will also affect other countries, since all national boundaries have become permeable to their transnational impact.

Notwithstanding the requirement to depict "an ASEAN" perception, this paper presents essentially "an" Indonesian view. It is hoped, however, that it will generate some useful discussion in order to get a more complete picture of the ASEAN countries' perception of the Japanese role in this region. While the changes that have taken place in the world, and in this region, have been most comprehensive and wide ranging, the focus of this paper is on the "politico-security" and "politico-economic" aspects of that role with the view to understanding its feasibility, possibilities, limitations, and constraints.

It is obvious that in the highly complex, sophisticated and fast changing contemporary world, the politico-security aspect cannot be separated from the politico-economic one. Both are inter-related, interacting and interdependent, and need to be addressed by governments in an integrated way, even though emphasis can be placed on either one aspect based on a careful analysis of all relevant factors and facts bearing on the problem to be solved in any period of time.

Politico-Security Situation

The INF Treaty concluded at the end of 1987 marked the dawn of a new era in super-power relations. Confrontation has made place for dialogue and negotiation. While this development will have a benign influence on the global politico-military scene, at the same time it will also make it more fluid, and therefore more uncertain. But fluidity itself does not necessarily lead to instability, as long as it is not blocked by haste, rash, thoughtless, and excessive measures.

Both superpowers are in the process of readjusting their priorities and strategies to the changed situation relative to each other and to other emerging powers in the world. This will lead to a further reduction of their role and influence in an increasingly multi-polar world. Bilateral, regional and multi-lateral interactions will become the pattern of international relationships, rendering "block power-politics" increasingly ineffective. The international system will be much more complex and potentially unstable, unless all countries, particularly the major ones, firmly commit themselves to international cooperation.

The warming superpower relations have created a climate conducive to major power accommodation, which has indeed been taking place. All major powers have shown a common interest in solving or abating regional conflicts, such as in the Persian Gulf, Western Sahara, Namibia, Afghanistan, Kampuchea, the Middle East, the Korean Peninsula, Central America, and so on.

In Asia and the Pacific the politico-security situation has also changed since Gorbachev began his peace offensive in the region marked by his Vladivostok speech in

July 1986, following it up with a number of concrete steps, such as pulling out an army division from Mongolia, SS-20 missiles, cutting back naval activities beyond Soviet territorial waters, starting the phased withdrawal of all Soviet troops from Afghanistan, applying pressure on Hanoi to speed up the solution of the Kampuchean problem, and so on. His second major speech delivered in Krasnoyarsk, in September the next year, contained more specific proposals, packaged in a "seven-point peace plan."

Gorbachev's peace offensive gained momentum that culminated in the Beijing Summit on May 16, 1989. The summit marked the normalization of Sino-Soviet relations after a rift of 30 years, and changed the triangular strategic relationship Moscow-Beijing-Washington. Gorbachev used the occasion to announce that out of the 200,000 soldiers to be pulled out from Soviet Asia, 120,000 men are troops stationed in the Soviet Far East. These cuts would remove 12 divisions of ground forces, disband 11 air force regiments and take 16 warships from the Soviet Pacific fleet, a cut of some 25 per cent of the total Soviet forces in the region.²

The normalization of Sino-Soviet relations will greatly influence the course of events in the entire Asia-Pacific region, transforming its politico-security landscape. It signaled the reduction of their mutual distrust and suspicion, and at the same time marked the beginning of confidence building, which would clearly benefit the whole region.

China would be able to concentrate her resources and energies on her four modernization programs emphasizing economic development, without the heavy burden of

²*Far Eastern Economic Review*, 25 May 1989, p. 13.

having to constantly watch her 7,500 kilometer long border with the Soviet Union. This is a great relief as the Soviet Union was and is the biggest potential security threat to her.

For Moscow, normalization offers the much sought after opportunity to participate in the economic dynamism of the region. Although most of the Soviet territory is in Asia, which makes her an Asian country, she has not been treated like one. Better relations with China, one of the world's major powers despite her relative backwardness, will facilitate Soviet access to the region.

Sino-Soviet normalization will also have a positive impact on the peaceful settlement of various problems in the region, such as the almost four decade-long Korean conflict, the return of Hongkong to Beijing's sovereignty in 1997, the unification of Taiwan with mainland China, the superpower bases in Southeast Asia, the Kampuchean problem, the claims and counter-claims in the South China Sea, and so on. But the most serious one appears to be "untouched" by this all, viz. Japan-Soviet dispute over the northern territories, potentially the biggest threat to the stability in Northeast Asia.

The Japanese Government will most likely continue to press for the return of these territories. But this could only become possible, if the Soviet Union were to conclude that Japan's military ties with the US had weakened, and that Soviet-Japan relations could counteract Japan-China relations. The issue of the northern territories is most difficult. It is linked with Japan-USA, Japan-China, Japan-Soviet relations. It is the biggest problem in the quadrangular Tokyo-Washington-Beijing-Moscow relationship. This will be the focus of alert in Northeast Asia, followed by the Korean peninsula.

And because of this dispute, the Soviet Union is the only country with which Japan has no peace treaty.

Politico-Economic Situation

International trade and investment flows have shifted to the Pacific during the last decade. The year 1984 saw trans-Pacific trade for the first time exceed trans-Atlantic trade and since then it has continued to grow. Of the US\$1.9 trillion total world trade that year, trans-Pacific trade accounted for 11.2 per cent, while trade across the Atlantic amounted to 10.8 per cent. This gave rise to the prediction that the 21st century would become the "Era of the Pacific."

Indeed, since the end of the Vietnam War, the economic growth of this region has been phenomenal, making it the most economically dynamic region in the world. A high proportion of the GNP of the countries in the region depends on trade, which is increasingly outward-looking. The region's strategic disposition is open, rather than driven by groupings or blocs. These elements of dynamism, openness, plus the great diversity of the region make pragmatism one of its characteristics. The desire for growth and prosperity is the driving and motivating force.

A remarkable development in the Asia-Pacific region lately is the emergence of new industrialized economies, known as NIEs, namely the Republic of Korea, Taiwan, Hong Kong and Singapore, with Thailand and Malaysia following not too far behind. All these nations, except Malaysia, are oil-importers which were severely hit by the two oil-shocks in the 1970s. But in the end they made a remarkable recovery, although with

a higher external liability than before. This shows a high degree of resiliency and flexibility of these nations which greatly facilitated adjustments and restructuring of their economies.

Japan has also successfully withstood the two oil shocks plus the yen appreciation. Moreover, instead of incurring a growing external debt she has become the world's financial superpower and largest creditor country. Because of the steep yen appreciation since 1985, Japan's overseas investment, especially in the ASEAN countries, has grown rapidly. Her import of manufactured products has also increased steeply, with ASEAN exports to Japan growing the highest. Japan has shown a remarkable resiliency and flexibility and has restructured her economy. It is said that she is now capable of growing on the basis of an expanding domestic demand.

All these developments have pushed intra-regional and investment within East Asia and established strong multilateral ties among the East Asian Countries. Moreover, trade and investment relations with the US and the European Community have also grown substantially. As a result these nations' economies have also become integrated with the world economy.

Such development has occurred in stark contrast to the economic stagnation of the region's socialist states like the Soviet Union, China, North Korea, the three Indochinese states and Burma. This has moved these countries to restructure their economies toward a more open and market oriented system, improve the diplomatic relations and increase economic intercourse with the non-socialist East Asian nations. This trend of development augurs well for the future of the region.

But the bright picture is clouded by the trade dispute between the two most economically powerful countries in the region, namely Japan and the US. The basic problem is both countries' persistent and huge trade imbalances. How the two countries will solve their dispute, how fast they will restructure their economies will greatly impact not only the countries in Asia-Pacific but the world at large.

Japan's Role in the Politico-Security Field

Security has always been the most important and the most controversial issue for Japan. Since the American occupation of Japan following her capitulation which ended the Pacific War, Japan has faithfully pursued every policy defined by the US, especially during the occupation period which lasted until 1951.

The vast American occupation apparatus was preoccupied with the attainment of two objectives: demilitarization and democratization of Japan, for which revision of the 1889 Constitution was required.³ The new constitution of Japan was promulgated on November 3, 1946, that contained the controversial Article 9 which since then has severely restricted Japan's defense posture.⁴

³See John K. Emmerson, *Arms, Yen and Power: The Japanese Dilemma* (Charles E. Tuttle, 1972), pp. 37-40.

⁴*Ibid.*, pp. 40-53. Article 9 reads: Aspiring sincerely to an international peace based on justice and order, the Japanese people forever renounce war as a sovereign right of the nation and the threat or use of force as a means of settling international disputes. In order to accomplish the aim of the preceding paragraph, land, sea, and air forces, as well as other potential, will never be maintained. The right of belligerency of the state will not be recognized.

The article renounce was arising not only from the right of belligerency but also from the right of self-defense, and hence, the right to maintain military forces. It was a thing unique of its kind in the world, that soon began to erode as the Cold War started to engulf the region.

The Korean War which broke out in June 1950 and which compelled General MacArthur to commit American troops stationed in Japan to Korea, required greater burden-sharing on the part of Japan in the maintenance of domestic order and stability. In July, 1950, a 75,000-strong "National Police Reserve" was created by order of General MacArthur as a supplement to local and provincial police forces and, without so saying, as the nucleus of a future military force.⁵

The American containment policy against Communist China in the Asia-Pacific region after the Korean War was developed and secured through bilateral and multilateral security treaties, including the "Treaty of Security between Japan and the United States of America of 1951" which was later superseded by the "Treaty of Mutual Cooperation and Security between Japan and the United States of America of 1960," still known as "Security Treaty." Whereas the scope of the 1950 Treaty was limited to only the military dimension of security, the 1960 Treaty has broadened it also to include political and economic cooperation,⁶ and served as the legal basis for the creation of Japan's Self-Defence Forces in 1954. The preamble to its operating articles which recognizes Japan's inherent right of individual or collective self-defense, provoked immediate

controversy and drew charges of conflict with Article 9 of the "Peace Constitution." Article V of the treaty clearly states US obligation to defend Japan against armed attacks.⁷

So since the occupation period Japan has been intimately involved in the evolving American politico-military policies, and the Government, based on the 1960 Security Treaty, has come to give a more flexible interpretation of Article 9 of the "Peace Constitution." It has maintained that Article 9 permits the right of self-defense and that the self-defense forces now in existence are constitutional, a view now strongly supported by the majority of the people. But it has also maintained that it is unconstitutional to join a regional security pact with military obligations or dispatch armed forces outside the country without amending the constitution. However, amending the constitution would spark bitter controversy since the "no-war clause" is still supported by the great majority of the Japanese people.

It can be concluded that the US-Japan Security Treaty is still of crucial importance to both countries. It is still the linchpin of US Asia-Pacific policy, and Japan is still

⁵Ibid., p. 55.

⁶Takuya Kubo, "Revaluation of Japan-United Security Treaty." Undated.

⁷Article V of the "Treaty of Mutual Cooperation and Security between Japan and the United States of America" reads: Each Party recognizes that an armed attack against either Party in the territories under the administration of Japan would be dangerous to its own peace and safety and declares that it would act to meet the common danger in accordance with its constitutional provisions and processes. Any such armed attack and all measures taken as a result thereof shall be immediately reported to the Security Council of the United Nations in accordance with the provisions of Article 51 of the Charter. Such measures shall be terminated when the Security Council has taken the measures necessary to restore and maintain international peace and security.

her single most valuable partner, at least for the foreseeable future, because of the following reasons. First, it prevents Japan from becoming a military power as this would cause great concern among the countries in the region and might trigger an arms race throughout the region. Memories of Japan's war atrocities have not disappeared. Second, Japan has become a great financial power, investing in the US and covering much of the US government's debt. And third, despite the frequent economic controversies and friction, which lately have become very sharp indeed, Japanese-American business relations provide technology, markets, talent, supplies, and other essential elements to both nations' companies.⁸

On her part, Japan would feel more comfortable with a United States that is strong, stable, and still the indisputable No. 1 superpower. Although there have been calls for an indigenous Japanese strategy independent from the US, Japan cannot and most likely will not distance herself from the US, because of her long history of cooperation with the US, the continued validity of the Japanese-American mutual security treaty and the benefits she gets from the cooperation in the economic, industrial and technological fields.

Nor does she want to remilitarize and become a military power. She is aware that she cannot become one, because her land space is extremely small, and therefore, vulnerable to nuclear attack. Japan is also lacking in natural resources and has to rely on others. Her emergence as a military power would pose a potential threat to her suppliers, and undermine the basis of her own economy

and security, which is economic interdependence. Japan's twentieth-century history in Asia implies that she will be much better accepted as an economic power and cultural force than as a major military power. Without actually becoming a military power, the world knows, that she could, if necessary, effect a rapid and substantial military build-up, because of her great economic, financial and technological strengths.

Thus over time Japan's concept of security has broadened evolving within and based on, the framework of Article 9 of the constitution and the US-Japan Security Treaty; the creation of the Self-Defense Force in 1954; the resumption of "normal" relations with the USSR in 1956; the enunciation of the three nuclear principles - no production, possession, or introduction of weapons; the normalization of relations with the PRC in 1972; and her experiences as mentioned previously. Economic interdependence is the basic foundation and precondition of Japan's security, which is popularly known as the concept of "Comprehensive National Security." Economic interdependence is also seen as Japan's greatest contribution to the security of other countries in the region.⁹

Based on this concept Japan's threat perceptions differ from Washington's. Among dangers that most alarm Tokyo are fear of losing access to overseas sources of food and energy, fear that Washington may be indifferent to Japan's need for vital imports and its need for access to the American and other markets, fear of loss of acceptability as an active partner in the economic

⁸James Fallows, "Containing Japan," *Atlantic*, May 1989.

⁹See Robert W. Barnett, *Beyond War: Japan's Concept of Comprehensive National Security* (Pergamon-Brassey's International Defense, 1984), pp. 8-10.

growth of Southeast Asia, fear of a breakdown of the international system, and fear of surges of great disorder anywhere.¹⁰

But there can be no doubt that as Japan's stake in trade and investment in the region grows, especially in Southeast Asia, and as the US continues to show relative economic and financial decline because of her "strategic overstretch," the pressure on Japan for "burdensharing" will go on. So far Japan has been most forthcoming on US pressures for burdensharing. Her defense budget has past the "one-percent-of GNP" barrier, and is now third largest in the world, after the US and the USSR. She pays about US\$2.5 billion, or 40 per cent of the costs of maintaining the 55,000-strong US military personnel in Japan, and she has twice as many destroyers as the US Seventh Fleet. But Tokyo is showing increasing resentment at the American attempt to tell Japan how to spend her money and at the constant harping on the need to share the burden of policies decided by the US.¹¹

So while taking over more burden from the US, Japan will maintain the American alliance and will still depend upon the treaty guarantee as a deterrent and a last resort. Former Prime Minister Nakasone, when he was Director General of Defense, stated positively that Japan would assume responsibility for the defense of sea routes in "near-by waters," but that any guarding of sea lanes in the vicinity of the Malacca Straits would be completely outside of Japan's purview and out of the question for the Japanese Maritime Self-Defense Forces.¹²

¹⁰Ibid.

¹¹Nayan Chanda, "The Stumbling Block," *Far Eastern Economic Review*, 30 March 1989.

¹²Emmerson, *Arms, Yen and Power*, p. 307.

That's a good thing, because any increased military role of Japan in the present situation where the emphasis is on disarmament and cooperation, is bound to be counterproductive for Japan herself, the US and for the entire region. No Asian country has quarrelled with a militarily strong Japan to protect herself. But there are strong feelings against a Japan who is powerful enough to threaten others. How best this can be achieved would depend on the consensus reached between Japan and her friends in the region, and this would need good and open communication and consultation.

Japan's Role in the Politico-Economic Field.

In spite of the long economic intercourse, many Southeast Asians still have mixed feelings about Japanese trade and aid. These feelings are a contradictory mixture of admiration and disapproval, of expectation and frustration, of desire and suspicion, of anxiety and irritation.

Until the mid-1970s the general feeling was one of anxiety over Japanese exploitation and domination. Southeast Asians resented too much Japanese economic influence and rebelled at the latter's high-handed methods, arrogance, and failure to understand and respect the customs and traditions of local peoples. They perceived the Japanese as exploiting natural resources in their own selfish interest, and Japanese aid as primarily benefiting Japan herself rather than the developing countries. They found the Japanese aloof, clannish, mysterious and too many. They saw Japanese tourists arrive in their own Japan Air Line plane, get in their Japanese bus, go to their Japanese

hotel, eat at their Japanese restaurant, enjoy themselves at a Japanese-owned night club, then get back to their plane and return to Japan. They could not see what was in that all for the Southeast Asians themselves.

This perception, unfortunately for the Japanese, is not confined to Southeast Asians. It is also shared by Europeans and Americans, Japan's closest allies and partners. They see Japan as a selfish nation who only think of their own interests, unwilling to restrain the one-sided and destructive expansion of its economic power.¹³ A recent poll in the US showed that more Americans regard Japan as a threat than the Soviet Union. Although Japan has become a financial superpower, she is perceived as continuing to use her financial strength to further Japanese interests, which are not necessarily the same as the world's, especially given her seeming compulsion to dominate every important value-added industry. Lacking the ideology, Japan will not sacrifice her own interests for the interests of the global financial system.¹⁴ The basic elements of Japanese politics are money and economic growth, which much continue to be pushed ahead even in world economy troubled with severe imbalances.

In short, Southeast Asians' image of the Japanese was that of "the ugly Japanese." One might recall the widespread riots in Bangkok and Jakarta in 1974 during former Prime Minister Tanaka's visit to those cities. But over time, there has been a gradual change for the better, thanks to the Japanese Government efforts to improve the image through various programs, such as "Youth Ship Program" and "Friendship Program

for the 21st Century." These programs lie in the cultural domain and are very important to cultivate mutual understanding of and respect for each other's culture, habits, customs, the prerequisites for promoting friendship, trust and confidence between ASEAN countries and Japan, if regional co-operation is to function at all.

The Japanese role in the politico-economic field can be summarized in trade, aid, investment, technical assistance and regional cooperation. Asian countries' economies, notably Northeast- and Southeast Asian ones depend heavily on trade. As mentioned earlier, Japan is either the largest or the second-largest trading partner of these countries. The old pattern of Japan's importing only raw materials from the developing countries and exporting finished products has gradually given way to a new pattern. The developing nations, especially the NIEs are now also exporting finished products to Japan, albeit still of somewhat lower technology. Multilateral trade of products of the same species but with different features in design, quality and price, is fast growing in the region, not only between Japan and the rest of the Asian countries but also between the NIEs and developing economies in the region, particularly between the NIEs, which include Singapore, and ASEAN countries. Electronic products can be cited as one example. Colour television sets and VCRs, radios and radio cassette players, are moving in all directions.

This has been made possible by the expanding industrial capacity of these countries through the acceptance of foreign investment, particularly from Japan because of the steep appreciation of the yen, and promotion of export-oriented industrialization. The result of this changing pattern is

¹³See Fallows, "Containing Japan."

¹⁴See Murphy, "Power without Purpose."

the emergence of regional interdependence. And this is where Japan can also play an important role, namely, to further stimulate regional trade by giving greater opportunities to the developing countries in the region to export their manufactured products to Japan, and also by promoting investments in the region particularly in export-oriented sectors.

In 1968 Japanese aid program for the first time exceeded one billion dollars and Japan moved to fourth place among aid giving countries, after the US, France, and West Germany. And about one decade later, the Japanese Government set its Fourth Medium-Term Target for ODA, under which Japan aims to provide more than \$50 billion over a five-year period and at the same time improve the quality of her aid.

Japanese aid has been much criticized because so much of it has been "private-based" as contrasted with direct government appropriated funds, or ODA. A recent OECD review of Japan's aid has concluded that the terms of her aid to the poorest countries remain hard, and that she fails to comply with the OECD's Development Assistance Committee (DAC) recommendation on the financial terms of assistance. The committee has "urged the Japanese authorities to continue to improve the financial terms of their aid to the least-developed and other low-income developing countries by expanding their grant aid and by further softening loan terms."¹⁵

Indeed, even though Japan is now the world's largest aid-donor country, she ranks lowest among the 18-member OECD's DAC in terms of the percentage of grants in her

total aid. Another complaint frequently aired is that a high proportion of Japanese aid is formally or informally "tied," so it comes back as purchase orders for Japanese equipment or contracts for Japanese construction firms. But this particular issue has been dealt with. Nearly two-thirds of Japan's ODA loan commitments are no longer tied to the purchase of equipment from Japanese suppliers. Too much bureaucracy is another criticism leveled at how the Japanese Government is handling her aid programs. Not less than a total of 16 ministries and agencies are involved in the administration of Japanese economic co-operation.

All these criticisms justify the previously mentioned perception that Japan's primary objective is self-interest. MITI, for example, has listed as the objectives of Japan's aid: first, to secure access to essential resources; second, to increase exports and strengthen the international base of Japan's economy; and (only) third, to fulfill Japan's obligation as the only advanced nation in Asia.

The rectification of all these and other shortcomings of Japan's economic cooperation, such as technical assistance which has been a very minor element of it, should be high on the agenda of Japan's role, and indeed, the Keidanren and the government are paying serious attention to these issues. In order for the aid programs to be more beneficial, Japan's aid regime should be able to respond to the diversified needs of the developing countries more efficiently.

Investment is a function of growth, and the rapid growth of the region's countries is testimony of that truth. Japanese direct investment showed an upward trend in early 1980s and reached US\$33.4 billion in 1987,

¹⁵*Far Eastern Economic Review*, 9 March 1989, p. 78.

making the aggregate for 1981-1987 a total of US\$139.3 billion. In terms of regional distribution, North America accounted for almost 40 per cent, followed by Asia 19.1 per cent, Latin America 18.1 per cent, Europe 15.1 per cent, Oceania (including Australia) 4.8 per cent, Africa 2.8 per cent, Middle East 2.2 per cent, and India 0.1 per cent.¹⁶ The majority of investments in manufacturing were in Asia (65 per cent in 1986) and a smaller number of cases in North America (27 per cent) and Europe (7 per cent). Investment in mining remained at a low level after reaching the peak in 1981, while approximately two-thirds of investments in commerce and service sector including finance, insurance and real estate business, went to North America and Europe, Latin America 20-25 per cent and Asia 7-12 per cent.

This upward trend is expected to continue, setting new records in the next couple of years. There have also been changes in the quality while "new moves" are under way. First, export-oriented type of investments have increased. Most assembly-makers have established large-sized factories in ASEAN countries in order to export relatively low grade home electric appliances to third countries and Japan. Some countries have started or expanded automobile export mainly to North America. Second, manufacturing investment in parts and materials has accelerated. Small- and medium-sized firms as well as big companies have expanded overseas production to meet the increased and upgraded needs of their clients in host countries. Third, new investments have spread from traditionally labour-intensive sectors to

technology and information-intensive areas and other service sectors. Establishment of technical centers, laboratories, component centers, industrial estates, consulting firms are such examples. Fourth, expansion of the domestic market has attracted domestic demand based industries, such as department houses and supermarkets.¹⁷ The prospect for the future is bright, with 42.7 per cent of Japanese direct investment going to North America, Asian NIEs 24.2 per cent, ASEAN 17.7 per cent, Europe 5.8 per cent, Africa 3.3 per cent, other Asia countries 2.5 per cent, Latin America 2 per cent, Oceania 1.3 per cent, and other European countries (East Europe) 0.5 per cent.

One last role in the politico-economic field that Japan is expected to play, is to stimulate regional cooperation. Beginning with the Colombo Plan, Japan has participated in virtually all multilateral groupings organized for economic development in Asia. Japan supports the principle of regionalism but one which is not based on exclusivism or protectionism but open and part of the global economy. But as the developing countries and NIEs continue to grow stronger and the economic intercourse deeper, problems and frictions will arise. This is natural, since frictions and problems exist only between countries with an intensive and extensive set of overlapping interests and relationships.

Taiwan and Korea, for example, have become great partners as well as rivals of Japan. South Korea's export surge has made Japanese business increasingly nervous, prompting trade disputes and slowing technology transfer. What has happened between the US and Japan has already started to happen between Japan and Korea, with

¹⁶See Gorota KUME, *Japanese Direct Investment: Recent Trends and Policies* (Research Institute of Overseas Investment, The Export-Import Bank of Japan, November 25, 1988).

¹⁷*Ibid.*

the big difference, that in the latter's case, it is Korea that has a trade deficit. Sound and healthy regional cooperation could prevent the countries of the region from resorting to unfair and unhealthy competition and practices.

Conclusion

As may have become clear, the Japanese are still looked upon as an insular people who, in spite of their massive international trade and increasing travel, have difficulty in breaking down barriers between themselves and peoples of the rest of the world. Communication is their most serious problem and must be addressed seriously, if they do not wish to be considered an "international outsider."

Japan knows that as she continues to grow stronger, accumulating huge surpluses and expanding her economic and financial influence, but without becoming "internationalized" at the same time, she is going to incur international wrath. The internationalization of Japan has been an issue since the early 1970s.

This paper has dwelled upon Japan's role in Asia-Pacific focusing on the politico-security and politico-economic fields. Its essence is epitomized in former Prime Minis-

ter Takeshita's "International Cooperation Initiative," as Japan's contribution to the world and Asia-Pacific. In his policy speech in Jakarta, on May 5, 1989, he explained the three pillars of the ICI, as follows:

The first pillar is the strengthening of cooperation to achieve peace. In keeping with Japan's Peace Constitution, we are firmly resolved not to become a military power such as might threaten our neighbors and are determined to do everything possible to use our abilities in cooperating for peace. From this perspective, Japan will undertake positive diplomatic initiative aimed at conflict resolution. Specifically, this means enhancing the level of our cooperation for achieving and maintaining world peace, including dispatching experts and other personnel to trouble spots and providing financial assistance for peace-keeping efforts.

Second is the expansion of Japan's Official Development Assistance (ODA). ODA is one of the areas where the world expects Japan to contribute most, and Japan has responded to these expectations by formulating a series of four medium-term targets for ODA enhancement and stepped-up support for the developing countries. I am determined to continue this effort, providing more and better ODA in the service of world peace and prosperity.

And third is the strengthening of international cultural exchange. Cultural exchange in the broadest sense is the foundation enabling people to transcend the value and systemic differences separating them and to achieve true mutual respect and understanding as human beings. At the same time, the stimulation of accompanying full-hearted exchanges among diverse cultures generates new vitality for the progress of the international community as a whole.

Japan, the USSR, and the PRC: Triangular Relationship in the Making

J. Soedjati DJIWANDONO

Introduction

IF DISCUSSIONS on the relationship between a set of three states in the framework of a triad or a triangle, especially one involving big powers, should assume complete independence and parity of all aspects of powers between them, then it would seem somewhat tenuous to treat Japan-USSR-PRC relationship as a triangle, particularly in the light of Japan's strategic alliance with, and dependence upon, the USA. It has been less uncommon to talk about Sino-Soviet-US triangle,¹ with the

PRC being regarded as an emerging or potential superpower in strategic sense pursuing an independent foreign policy, at least since its rift with the Soviet Union.

Indeed, with Japan's foreign policy increasingly independent from the USA, particularly with respect to its relations with the Soviet Union and the PRC, and the general perception of Japan as having the potentials to be a superpower in its own right, not only as an "economic superpower," and hence concern on the part of many states including the Soviet Union and the PRC over what they perceive as a threat coming from a possible revival of Japanese militarism, one can indeed speak of the big power triangle of Japan-USSR-the PRC in strategic, political, and economic terms just as one would speak of the Sino-Soviet-US triangle. Yet, because of its close alliance with the USA, Japan is more often than not seen and judged in the light of its alliance association with the USA.

Paper presented at the Fifth US-ASEAN Conference, Singapore, June 11-16, 1989, sponsored by CSIS (Jakarta), IEAS (California) and SIAA (Singapore).

¹See, for instance, Gerald Segal, *The Great Power Triangle* (London: MacMillan Press, 1982); Raju G.C. Thomas, ed., *The Great-Power Triangle and Asian Security* (Lexington, Mass.: D.C. Heath, 1983); Ha Yong-Chool, "Triangular Relationship and the Chinese Perceptions of U.S.-Soviet Detente," *Sino-Soviet Affairs*, vol. X, no. 3 (Fall 1986), pp. 27-48; and J. Soedjati Djwandono, "The USA, USSR, and the PRC: Triangular Relationship," a paper presented at the

Fourth ASEAN Institutes of Strategic and International Studies Conference: ASEAN-United States Relations, Singapore, 27-30 June 1988.

It is thus to be borne in mind that in considering the triangular relationship between Japan, the USSR and the PRC, the role of the USA may not be altogether excluded, not only because of its alliance with Japan but also because of its important alignment with the PRC as well as its unique and dominant relationship with the Soviet Union, so that Japan-USSR-PRC triangular relationship may, in a sense, be regarded as forming part, as it were, of a big power quadrangular relationship.

Such an assumption of complete interdependence and parity, however, may not necessarily be of relevance to and therefore underlie any discussion of a triangular relationship between states, even among such big powers as Japan, the USSR, and the PRC. In fact, a triangular relationship between a set of three states may be said to exist to the extent that the bilateral relationship between any two of them is a function of each state's relations with the third, and that the nature of the bilateral relationship between any two of the three states affects in one way or another the third state's relations with each of the other two. Thus one has referred also to US-Japan-ASEAN triangle.²

To be sure, the triangular pattern in which to discuss the relationship between Japan, the USSR, and the PRC is certainly just one way of approaching and analysing the international system or at least a part of it. Relations and interaction among nations in this increasingly interdependent world have been so complex as to defy analysis of interaction between any two or more states

in isolation completely separate from the wider context of the international system. Thus although in triangular relationship as tentatively defined above, in its relations or interaction with another a state will take into account primarily its relations and interaction with a third state, its interests, and possible reaction, relations with other states outside the triangle, big or small, their interests and possible reactions, are likely to enter into its calculations as well. Hence the importance of the US factor referred to above. In fact, nations outside the triangle not infrequently serve as the common object, common denominator, and common centre of attention of the states in the triad or triangle. The crisis of Laos in 1961 involving the USA, the Soviet Union and the PRC was a case in point.³

Indeed, it is not always easy to determine whether calculations on a state's relations with those outside the triangle are more or less important considerations in its interaction with another state in the triangle than considerations of possible impact on or reaction on the part of a third state. It would seem to depend in part on the nature of the triangular relationship, that is to say, adversarial and competitive or detente and cooperation, which considerations will take precedence. Ultimately, of course, considerations of that state's own national interests, however defined, are likely to prevail.

This paper will attempt to trace briefly the development of Japan-USSR-PRC triangular relationship and examine the prospect of its coming to fruition. And given the full establishment of that triangle, it will examine the possible implications for South-east Asia, particularly ASEAN.

²See, among others, Charles E. Morrison, *Japan, the United States and a Changing Southeast Asia* (New York: Lanham, 1985), particularly Chapter III, pp. 28 ff.

³Segal, *Great Power Triangle*, pp. 9 ff.

Changing Triangular Relationship

The nature of the triangular relationship between Japan, the USSR, and the PRC has been changing through distinct stages of development. The emergence of the communist PRC in the midst of the unfolding Cold War understandably resulted in its alliance with the Soviet Union against the USA. This Sino-Soviet alliance signed on 14 February 1950, however, was not only directed against the USA as the arch enemy of the Soviet Union in the Cold War, its ally, but also explicitly against Japan, an ally of the USA and historically a primary source of external threat to its security. Despite Japan's defeat in World War II, fear of a possible revival of Japanese military power clearly characterized the attitude of the new China towards Japan. Thus its Treaty of Friendship, Alliance, and Mutual Assistance with the Soviet Union was to protect it from Japan as well as the USA. Article I of the treaty provided that in the event of the PRC or the Soviet Union "being attacked by Japan or any state allied with her and thus being involved in a state of war, the other Contracting Party shall immediately render military and other assistance by all means at its disposal."⁴

The decade beginning with the signing of the now defunct Sino-Soviet Treaty in 1950 may be described as the first phase of Japan-USSR-PRC triangle. If in a negative sense, Japan served as the pivot of that triangle, against which, together with the USA, the hostility of the Sino-Soviet alliance was directed. If, however, as already mentioned, Sino-Soviet attitude towards Japan was determined by both the Cold War -- because of

its alliance with the USA -- and recent past experience of World War II, Japan's attitude towards the Soviet Union and the PRC seemed to have little to do with the Cold War except in the sense that its attitude was influenced by the USA, intentional or otherwise. This was true especially with respect to its policy towards the PRC, which accounted for its recognition of Taiwan instead of the PRC as condition for its independence under the San Francisco Treaty of 1951.⁵

Apart from US influence, on the other hand, Japan has had its own special consideration of national interests in pursuing an anti-Soviet posture throughout the postwar years as will be clear below. Indeed, this consideration has been so overriding that unlike in other areas of foreign policy, no periods of Soviet-US detente, including the current one, seem to have rubbed off significantly on Japan's relations with the Soviet Union. And it may be argued that relations with the Soviet Union has been one of the few cases that have provided Japan with an opportunity to pursue a foreign policy increasingly independent of the USA. That Japan's attitude towards both the Soviet Union and the PRC had little to do directly with the Cold War seems to have been attested by the fact that the Sino-Soviet treaty of alliance was signed well before the outbreak of the Korean War, which marked the beginning of the extension of the Cold War and the US containment policy from Europe to Asia.

The triangular relationship entered its second phase with the onset of the Sino-Soviet dispute around the beginning of the following decade of the 1960's. This phase was characterized basically by a three-way hostility. In the meantime, however, Japan had main-

⁴Quoted in F.C. Langdon, *Japan's Foreign Policy* (Vancouver: University of British Columbia Press, 1973), p. 95.

⁵Ibid., p. 94.

tained diplomatic relations with the Soviet Union, if without a peace treaty, and had begun to pursue a "two-China" policy, separating politics from economics, whereby it maintained diplomatic relations with Taiwan while promoting commercial and cultural relations with the PRC at the unofficial level despite embargo by the West. With the widening and hardening conflict between the PRC and the Soviet Union, therefore, Japan may be said to have continued to serve as the pivot of the triangle, if now in a more positive sense.

In the meantime, it may be noted that perhaps in part because of its detente with the Soviet Union during the decade, which helped to exacerbate the Sino-Soviet dispute, the USA, and Japan for that matter, were yet to exploit the dispute to their own advantage. On the contrary, US containment in Asia was then more directed against the PRC, particularly with regard to the Vietnam War, in which the PRC played an increasing role.

What seemed partly to be an attempt by the USA to take advantage from the worsening Sino-Soviet dispute was only undertaken in early the following decade of the 1970s with the beginning of rapprochement between the USA and the PRC, followed by Japan, which in fact even outdistanced the USA in opening diplomatic relations with the PRC. The third phase of Japan-USSR-PRC triangle had begun, characterized by Sino-Soviet alignment against the Soviet Union. This was to some extent similar to the first phase of the triangle with the Soviet Union instead of Japan serving as a pivot in a negative sense, although both Japan and the PRC continued to maintain diplomatic relations with it.

The third phase of Japan-USSR-PRC triangle was an interesting and important period in Japan's foreign policy. As mentioned earlier, in the context of its "two-China" policy, Japan had fostered commercial and cultural relations at an unofficial level, that is to say, while maintaining diplomatic relations with Taiwan instead of the PRC. By 1969 total bilateral trade between Japan and the PRC had reached US\$600 million, making Japan the biggest trade partner of the PRC after Hong Kong. In 1972 it reached US\$1.1 billion prior to the opening of diplomatic relations between the two countries.⁶

Indeed, policy towards the PRC had been one of the most controversial issues of the 1960s with the Japanese government withstanding persistent public pressure for normalization of relations at the same time continuing to try not to disrupt US containment policy.⁷ In 1970 President Nixon and Prime Minister Sato agreed on the necessity for the USA and Japan to coordinate fully their policy regarding the PRC and on the maintenance of close communication and consultation about future developments on the issue. This was reaffirmed in the following year in a series of top-level US-Japan exchanges. Yet Japan was to learn about President Nixon's definite move towards the PRC only very shortly before he went on the air to make his historic announcement.⁸ This was one of the Nixon shocks.

Subsequently, enthusiasm in Japan for normalization with the PRC was greatly re-

⁶Shibusawa Masahide, *Japan and the Asian Pacific Region* (London: Croom Helm, for the Royal Institute of International Affairs, 1984), p. 171.

⁷Ibid., p. 64.

⁸Ibid., p. 63.

inforced. It was regarded as the only way to restore the nation's self-respect and international standing that had been seriously undermined by US policy. A sense of guilt felt among the Japanese about the damage that they had inflicted on the Chinese during the war was an additional factor influencing the policy of the Japanese government towards normalization of relations with the PRC in the following year further and faster than the USA, now that Japan was liberated at last from the need to defer to it.⁹ A joint communique between President Nixon and the new Japanese Prime Minister Kakuei Tanaka in Honolulu at the end of August 1972 before his trip to Beijing confirmed their parting of ways. It made no mention of the Taiwan question. Japan had decided to sever official relations with Taiwan, when the USA was not ready. It was finally to reverse the position forced upon it by the USA in 1952. On 29 September a joint communique between Prime Minister Tanaka and his opposite number Mr. Zhou En-lai declared that Japan had established diplomatic relations with the PRC. It also stated that Japan realized its responsibility "for causing enormous damages in the past to the Chinese people through war and deeply reproaches itself." Japan agreed further that "Taiwan is an alienable part of the territory of the PRC."¹⁰ All these fulfilled the conditions laid down by the PRC for its normalization of relations with Japan.

The PRC, for its part, had its own goals in its policy towards Japan apart from the principles governing the issue of Taiwan. It aimed at strengthening cooperation against Soviet influence in the Asia-Pacific region; utilizing Japan's economic power, technolo-

gy and financial capacity to modernize its economy; and impeding any developments that might allow Japan to become a military threat again.¹¹ In the meantime, the Soviet Union did attempt to lure Japan away from the PRC (and USA) by sending Foreign Minister Andrei Gromyko to Tokyo in January 1972. But it seemed only to have given the PRC an added incentive to hasten the process of normalization with Japan.¹²

In the context of the triangular relationship, however, Japan, despite closer alignment with the PRC, attempted to pursue as much as possible an equidistant attitude towards the other two big powers, the PRC and the Soviet Union. Therefore, while aligning more closely to the PRC, Japan meanwhile promoted economic relations with the Soviet Union, which was aided by the geographical proximity of the two countries. Soviet exports of fuel, timber, and other raw materials were needed by Japan, which in return exported machinery and other processed goods. The oil shock of 1973 encouraged Japan to approach the Soviet Union in search of Siberian resources. It was also active in efforts for the development of Soviet forestry resources and other large scale Soviet development projects in the mid 1970s. In 1976 a Keidanren delegation visited Japan. And in 1977 a bilateral agreement on fisheries was concluded between the two countries.

Japan's attempt not to antagonize the Soviet Union too much thereby provoking Soviet hostility and enhancing the Soviet threat was clearly seen during its discussions

¹¹Susan L. Clark, "Japan's Role in Gorbachev's Agenda," *Pacific Review*, 1/3 (1988), p. 285.

¹²Shibusawa, *Japan and the Asian Pacific Region*, p. 66.

⁹*Ibid.*, p. 66.

¹⁰*Ibid.*, p. 67.

with the PRC on the draft Treaty of Peace and Friendship, particularly on the so-called anti-hegemony clause. The Soviet Union itself was reported to have offered in 1976 to return two islands of the Northern territories, a continuing obstacle to improvement in Japan-Soviet relations, if Japan would refuse the anti-hegemony clause in its Treaty of Peace and Friendship with the PRC. Indeed, finally while the anti-hegemony was preserved, an additional sentence was inserted, which says that "The present treaty shall not affect the position of either contracting party regarding its relations with third countries."¹³ The Treaty was subsequently signed. One effect of the signing of the treaty was that it brought a change in the PRC's position regarding Japan's military alliance with the USA, which had previously been criticized by the PRC.¹⁴ For its part, however, the Soviet Union reacted by cancelling Foreign Minister Gromyko's visit to Japan in 1978, the year that also marked the last visit to Moscow by a Japanese Foreign Minister (Mr. Sonoda) for many years to come.

Normalization in Japan's relations with the PRC, however, despite their alignment against the Soviet Union during this third phase of their triangular relationship, has not been free from occasional strain. The PRC, like some other Asian countries, has also expressed concern over Japan's increased defence spending. There has also been strain in the relations between the two countries created by often differing interpretations of Japan's role in China during World War II.¹⁵

¹³Clark, "Japan's Role," p. 285.

¹⁴Ibid.

¹⁵*Kompas*, 29 April 1988.

In spite of their diplomatic relations since 1956, relations between Japan and the Soviet Union have understandably been subject to more frequent strains. The main reason for continuous anti-Soviet feeling in Japan has been the Soviet occupation of the Northern Territories. And related to this has been the deployment of Soviet military forces on those islands, including the deployment of nuclear -- capable ground -- launched cruise missiles on Etorofu Island as of October 1985.¹⁶ This has served to reinforce the Soviet threat to the security of Japan. The so-called Toshiba Affairs of 1987, which has a trade agreement between Japan and the Soviet Union reportedly allowing the Soviets to develop a quieter submarine propeller caused repercussions in Soviet-Japanese relations as well as in Japan's relations with the USA. And in April of the same year Japan and the Soviet Union expelled each other's diplomats and businessmen on charges of spying.¹⁷ And lastly, following the USA, Japan boycotted the Moscow Olympics in 1980 because of the Soviet invasion and occupation of Afghanistan in the previous year.

Triangular Relationship in the Making?

The development of Sino-Soviet detente beginning in the early part of the present decade, which has been topped by the Sino-Soviet summit meeting between Mr. Gorbachev and Mr. Deng Xiao-ping in Beijing in May 1989, marked the entry of Japan-USSR-PRC triangular relationship into its fourth phase. Moscow's own efforts to improve relations with the PRC can be traced back to

¹⁶Clark, "Japan's Role," p. 287.

¹⁷Ibid., p. 279.

the last years of the Brezhnev regime. Following his appeal for Sino-Soviet rapprochement in a speech at Tashken in March 1982, the two countries began gradual process to improve relations. The new impetus for Sino-Soviet detente, however, has been provided by the ascendancy of Mr. Mikhail Gorbachev to power in the Soviet Union. In his now famous speech at Vladivostok on 28 July 1986, which marked the beginning of Soviet peace initiatives in the Asia-Pacific region, Mr. Gorbachev gave special emphasis on Soviet relations with the PRC. It was in that speech that for the first time the Soviet leadership touched on the three conditions laid down by the PRC for normalization of relations between the two countries. Previously the Soviets had always rejected any link between the three conditions and Sino-Soviet relations on the ground that they affected "third countries."

Among the Soviet motives for developing detente with the PRC has been the Soviet response to the PRC's opening up to the USA and Japan. The Soviets, therefore, have attempted to wean both the PRC and Japan from the USA for fear of a possible military triangular alignment, if not alliances, between the USA, Japan, and the PRC.

Indeed, for some time, fearing Soviet encirclement, the PRC had endeavoured to form an international anti-Soviet united front between Japan, western Europe, the PRC, and the USA or what it called international anti-hegemonic united front.¹⁸ Mr. Deng Xiao-ping said in 1979 that:

¹⁸For a more detailed analysis see Dieter Heinzig, "The Origins of Sino-Soviet Detente: A Reappraisal," *Sino-Soviet Affairs*, vol. X, no. 2 (Summer 1986), pp. 157-169.

After setting up this relationship between China, Japan and the US, we must further develop the relationship in a deepening way. If we really want to be able to place curbs on the polar bear, the only realistic thing for us is to be united. ... it is not only of interest to China but also of great significance to world peace, world security, world stability, that there be friendly relations between China and the US, Europe and Japan.¹⁹

The USA, however, at the time entering a new era, if short-lived, of detente with the Soviet Union, was not interested in the formation of such an anti-Soviet global alliance. President Carter declared, among other things, that it was self-evident that the two countries, the USA and the PRC, did not share the same security interests and that China could not share the United States' responsibilities.²⁰

Failing in such an endeavour, and added to that the introduction and passage of the Taiwan Relations Act in the USA, the PRC may have no longer felt secure in its anti-Soviet alignment with the USA, especially in the face of Soviet military buildup. There was need for the pursuit of an independent foreign policy, and improving relations with the Soviet Union the PRC may hope to have some leeway in dealing with the USA. At the same time, both the PRC and the Soviet Union shared certain developments in their respective domestic scenes, namely the ascendancy of pragmatic leadership dedicated to reforms, and hence the need for peaceful international environment.

In the context of its triangular relationship with Japan and the Soviet Union, moreover, the PRC's economic relations with the

¹⁹An interview on January 24, 1979, *Time*, February 5, 1979, as quoted in *ibid.*, p. 163.

²⁰Quoted in *ibid.*

Soviet Union may for some time to come prove more beneficial than with Japan. Both the PRC and the Soviet Union, for instance, are willing to trade on a barter system because of foreign currency problems that both are facing. And both are willing to accept lower quality goods, although both are at the same time competitors in the world market for high technology goods.²¹

The present phase, the fourth, in Japan-USSR-PRC triangular relationship has been marked by Sino-Soviet detente and alignment, Sino-Japanese alignment, and strained and not fully normalized Japan-Soviet relations. In this sense, the PRC may be said to serve as the pivot of the triangle. With full normalization of relations between Japan and the Soviet Union, if and when a peace treaty is concluded between the two countries, the triangular relationship will come to full fruition. At this stage, Japan-USSR-PRC relationship appears like a triangle with one side missing or at least not fully and firmly in existence.

As regards Japan's attitude towards its relations with the Soviet Union, not much more can be said. Japan continues to demand the return of all the four islands of the Northern Territories as a condition for full normalization of relations with the Soviet Union crowned by the signing of a peace treaty between the two countries. For its part, however, the Soviet Union has changed its view of Japan, although it has understandably given a higher priority to the PRC than to Japan and despite continued ambivalence, particularly as regards what the Soviet Union, like the PRC and some other Asian countries, has continued to perceive as the threat posed by the possible revival of

Japan's military power, even in the context of burden-sharing with the USA.

The issue of the Northern Territories remains the most crucial one, and probably the main obstacle, in the way of full normalization of Japan's relations with the Soviet Union. There is no need here to dwell on the territorial issue. While some compromises have been reported, particularly the possibility of returning only two of the islands to Japan, the tendency of the Soviet Union seems to be to offer closer relations and cooperation in various fields to Japan as reflected in Gorbachev's speech at Vladivostok as well as his statements and remarks on many other occasions, at the same time avoiding mention of the issue.

Indeed, no prospect of a settlement by way of a compromise seems to be in sight. But some compromise may ultimately be the only alternative solution. But to discuss this problem in detail would be beyond the scope of the present discussion. Suffice it to say, that perhaps, as one scholar has put it, "Japan's only hope for progress on Northern Territories issue is in the context of a long-term military relaxation in the region and a correspondingly reduced role for the US military in Japan, and after a new atmosphere has been created through advances in other aspects of Soviet-Japanese relations."²² On 15 September 1967, Senator Mike Mansfield of the USA suggested at the Shimoda Conference of Japanese and American scholars and politicians the holding of a great power meeting on Japanese security and territorial questions. He thought that

²²Gilbert Rozman, "Moscow's Japan-Watchers in the First Years of the Gorbachev Era: The Struggle for Realism and Respect in Foreign Affairs," *Pacific Review*, 1/3 (1988), p. 267.

²¹Clark, "Japan's Role," p. 286.

both the United States and the Soviet Union could make mutual concessions with respect to the southern and northern occupied territories which they held in the process of a joint guarantee of Japan's security. He suggested the inclusion of the PRC in the joint guarantee.²³ In this area of great power detente, except in the relations between Japan and the Soviet Union, perhaps some idea along that line may be worth looking into in efforts that would ultimately pave the way for a settlement of the territorial issue between Japan and the Soviet Union. But whatever the solution, this alone would complete Japan-USSR-PRC triangular relationship. It is clear that with the evolving great power detente, be it Sino-US, Sino-Japanese, Sino-Soviet, and Soviet-US, it is Japan-Soviet detente that is missing or lagging behind.

Implications for ASEAN: A Conclusion

Any big power relationship that has been characterized by one form of hostility or another has had adverse implications for Southeast Asia, and later also ASEAN after its establishment over two decades ago. The new nations of the region emerged as independent states, except Thailand, mostly in the midst of the unfolding Cold War, which helped to shape not only their respective foreign policies, and hence the pattern of their alignment or alliance, but also their domestic political constellation. The first phase of Japan-USSR-PRC triangular relationship, therefore, did not have a direct implication for Southeast Asia except to the extent that it essentially formed part of the

Cold War. The successive Indochina wars were in that sense a function of East-West confrontation. But with the onset of the second phase of Japan-USSR-PRC triangular relationship, and well into the next phase, the continuation of the Vietnam war was at the same time also a function of the Sino-Soviet conflict. The same is true with the subsequent conflict in Kampuchea, which was to some extent also a function of the Sino-Soviet conflict, which formed part of the third phase of Japan-USSR-PRC triangular relationship.

This is not to suggest that regional conflicts in Southeast Asia, or elsewhere around the globe, have been primarily instigated by external powers or consequent upon the nature and pattern of their relationship. But big power relationship characterized by competition and hostility would likely induce each of the big powers to seek friends and allies. Such a nature or pattern of relations among major powers would thus enable the regional states to solicit big power military and other forms of aid and assistance. Indeed, such states would often emphasize their mutual hostility in their efforts to win support from their respective allies among the big powers, even if their conflicts have genuine roots that are internal or regional rather than external in nature.²⁴ Thus with big power detente and cooperation, there would be less possibility of a link between protagonists in domestic and regional conflicts with external major powers and less opportunity for such protagonists to solicit

²³Langdon, *Japan's Foreign Policy*, p. 134.

²⁴This kind of analysis is applied to the Korean peninsula by George Kunadze, "Problems of the Korean Peninsula," a paper presented at the Northeast Asia Symposium in Tokyo, 25-27 May 1989, sponsored by the *Yomiuri Shimbun* and Institute for Sino-Soviet Studies, George Washington University.

support and aid from major powers. There would be less possibility of regional states becoming big power proxies. And with less need for external allies, all these would help contain and perhaps prevent domestic and regional conflicts.

It would be in the interest of Southeast Asia, therefore, particularly ASEAN, to have the Japan-USSR-PRC triangular relationship come to fruition, characterized by detente and cooperation, despite occasional strains, rather than hostility between any two or between the three of them. This is yet to develop. It is, hopefully, in the making. This would materialize if and when Japan and the Soviet Union should follow suit in the present of big power detente.

To be sure, not all will be well given the making of Japan-USSR-PRC triangular relationship. For some time to come, the triangle may not be in the interest of ASEAN in the sense that the Soviet Union and the PRC should become the focus of Japan's economic activities so that these two big countries may become ASEAN's competitors as markets, sites of investment and targets of technology transfer. Japan may have less interest in ASEAN.

At the same time, however, Japan-USSR-PRC triangle characterized by detente and cooperation, as part of the big power detente in general, may help create and maintain regional peace and stability which would be conducive to trade and economic cooperation, thereby assisting the national developments of the ASEAN states. This may be achieved through the positive and constructive roles that the big powers can play in the efforts at a peaceful settlement of regional conflicts such as the Kampuchean issue.

Moreover, the development of Japan-USSR-PRC triangular relationship characterized by detente and cooperation would help improve the images of these big powers, which in turn would help improve their relations with the regional powers, particularly the member states of ASEAN. And if there should be any fear of the threat of a big power collusion, Japan would be able to serve as a check or constraint on a possible resurgence of Sino-Soviet alliance, just as the Soviet Union may serve as a check or constraint on a possible, if unlikely, Sino-Japanese collusion. The making of Japan-USSR-PRC triangular relationship in its proper sense would serve the interest of security and stability of ASEAN, and indeed of Southeast Asia.

The Major Powers and Regional Issues in Southeast Asia

Hasjim DJALAL

Introduction

I SHOULD discuss regional issues in Southeast Asia at least in three sub-topics, namely:

1. The roles of the USSR, PRC and Japan in Southeast Asia. In discussing the roles of the three powers, one cannot avoid a discussion on the internal developments in the three powers as well as the internal developments and the role of the United States;
2. The issue of the Zone of Peace, Freedom and Neutrality (ZOPFAN) in Southeast Asia and its influence on regional developments. Here again it cannot be avoided that the discussion would have to touch upon the concept of Nuclear Weapon Free Zone in Southeast Asia (SEAN-WFZ);
3. Indochina and ASEAN. Here the discussion would have to take into account the recent developments in Indochina and in ASEAN, the efforts to seek solution to the Kampuchean question, as well as other factors that promote or hinder relations between Indochina and ASEAN.

While the topics are defined in the above terms, there are nevertheless other regional issues that need to be taken into account, such as developments in the South China Sea and in the Indian Ocean. In fact the existing numerous bilateral issues in Southeast Asia, either among ASEAN or Indochinese countries or between the two groupings, may in the end become regional issues as well if they are not handled properly. Equally, developments in the Indian sub-continent and the Indian Ocean, in which India seems to be moving into a bigger role, should also be taken into account, especially in view of the seemingly increasing interests of India to play a role in seeking solution to the Kampuchean problem.

Paper presented at the Third Indonesia-US Bilateral Conference, Bali, 27-31 August 1989, co-sponsored by CSIS and the Asia Foundation Center for Asian Pacific Affairs (CAPA).

The Soviet Union

There have been significant developments in the Soviet Union recently which have affected its policy and roles in Southeast Asia. The rise of Gorbachev in fact has brought about *perestroika*, *glasnost* and democratization in the Soviet Union. The economic stagnation in the Soviet Union within the last 10 to 15 years have necessitated the restructuring of the Soviet economy by giving more initiative to economic units and by encouraging the development of cooperatives. The very rigid and closed Soviet society in recent past that has stifled initiative and development has necessitated a certain degree of openness and freedom of expression. Equally, the very high concentration of decision making in the hands of the Party leader or leaders, have also brought about the need for much more decentralized decision making process.

These developments have brought about some impact on Soviet domestic as well as foreign policy. Domestically, it has encouraged expression of opinions, more liberalisation in economic management and some tolerance towards differing opinions. In fact, there has been noticeable improvement in human right area. It has also brought the revival of "nationalism" among the various nationalities inside the Soviet Union, particularly in Central Asia and in the Baltic.

In foreign policy the Soviet Union has been able to pursue increasing initiatives on arms control and arms reduction, intensified its efforts to diminish tensions between Western and Eastern Europe even to the point of suggesting "a single European home." The pursuit of reforms in the Soviet Union even risks the possibility of the disintegration of a monolithic communist structure in Eastern Europe.

More important to Southeast Asia is of course the changing and increasing attention the Soviet Union gives to the Pacific as a whole, including Southeast Asia. The Soviet Union now wants to develop its resources in Siberia and its far eastern provinces; it wants to mend its relations with Japan and to join the Pacific Economic Cooperation Conference, and in fact would even like to be one of the dialogue partners of ASEAN.

Soviet policy towards the Pacific region as a whole seems to have brought about some results:

1. After almost thirty years of estrangement, it has now been able to normalize its relations with the PRC;
2. It has tried, although less successful for the moment, to improve its relations with Japan;
3. It has attempted to solve regional problems by, among others, withdrawing its forces from Afghanistan;
4. It has also been able to develop some kind of relations with South Korea and even Taiwan, albeit in trade and economic fields;
5. It plays a greater role in the discussion of political, strategic and economic issues in the Pacific;
6. It has broadened its attention to the South Pacific;
7. It has been able to improve relations with ASEAN through its policy of encouraging Vietnam to seek a comprehensive political solution to the Kampuchean problem; and
8. It has been able to maintain and promote good relations with ASEAN member countries, particularly recently with Thailand and the Philippines.

It seems that the recent changes in the Soviet Union are genuine. The Soviet Union

is looking more respectable now. The Pacific region is responding to its overture slowly but it seems surely. Even the United States and the West are encouraging the new Soviet direction. The Southeast Asian region also seems to respond favourably to the Soviet overture. It is therefore clear that the Soviet Union is increasingly playing or willing to play a more constructive and positive role in Southeast Asia.

The significant change in Soviet foreign policy recently seems to have brought about the so-called "new thinking" which in effect gives more emphasis to economic development than to worldwide ideological drive. The "new thinking" seems to indicate that the missionary zeal in the past in the form of world-wide class struggle seems to have changed. Although the Soviets may still believe that class struggle still exists, it seems no longer the primary priority in Soviet foreign policy today; it seems to have been replaced by the need of mankind as a whole, including the Soviets, to prevent nuclear annihilation, ecological deterioration, North-South discrepancies, population problems, etc.

It seems that the Soviet Union is now willing to accept "freedom of choice" by nations world-wide, including within the Communist Bloc, to the point that it seems to have even abandoned the right to intervene if it thinks that other socialist countries have gone astray (Brezhnev Doctrine). It seems also that the Soviet Union is willing to replace the concept of "balance of forces" with the concept of "balance of interests" in accordance with international law.

It is clear of course that the basic motivation for the changes in the Soviet Union is its economic predicament. It is also clear that the future relations between the South-

east Asian region and the Soviet Union would depend a great deal on the ability of both sides to develop a mutually beneficial economic relations given the fact that the Soviet Union is pursuing less aggressive ideological penetration to Southeast Asia, particularly to ASEAN. The economic factors, however, at least so far, do not offer a very bright prospect for the development of the relations, although both sides are willing to explore them.

The People's Republic of China

The *four modernisation* efforts in China have indicated some results, at least until recently. The efforts to improve the economic base of China through proper management of agriculture has brought about some improvement in the rural areas, although it has also brought problems to fixed income earners in the cities. In fact, this, ironically, seems to have become one of the sources of troubles for China recently. Its modernisation in industry has made China more competitive and seems to have also made an impact regionally. In science and technology the PRC has been able to take benefit from Western supremacy, although some constraints exist on the transfer of high technology. In defence, the PRC has been able to enlarge its own defence industries and has become a major exporter of weapons. In fact, it has also developed some blue water naval capabilities, presenting new situation to South and East China Seas.

Compared to the Soviet Union, the modernisation efforts in China have brought about more turmoil. This seems to have been caused by the lack of progress in political reforms, especially in democratic decision making process in China. The process of

reform, largely motivated by economic necessities, have created internal conflicts that pose a danger to the reform and modernisation efforts themselves.

On the basis of the changes that have taken place in China, its foreign policy has also been undergoing some changes. Like the Soviet Union, it seems that it has now become more economically oriented and less ideological than before, regionally and internationally. It has also been able to normalise its relations with the Soviet Union and Japan. The PRC has also exerted some influence in Southeast Asia by improving relations with ASEAN. One of the notable changes has been the possibility of normalising relations with Indonesia after 20 years of diplomatic freeze.

Although the PRC's policy of continued strong support for the Khmer Rouge in Kampuchea poses some problems in improving PRC-ASEAN ties as was indicated by the result of the last Jakarta Informal Meeting (JIM) process, the relations have generally been cordial. Until recently, economic relations between the PRC and ASEAN have developed very significantly. Taking into account the basic similarities of the PRC's and ASEAN's position with regard to the Kampuchean problem in the sense that both sides want the Vietnamese to withdraw from Kampuchea, and the Chinese support to the ASEAN concept of ZOPFAN and Southeast Asia Nuclear Weapons Free Zone (SEAN-WFZ), it seems that ASEAN has within the last several years regarded the Chinese role in the region as generally positive.

The recent development in China, in which bloodshed took place at the Tiananmen square, has brought back some doubts

as to the future role of China. The events at Tiananmen square have raised spectre in Southeast Asia of the possibility of the PRC taking equally harsh measures should some developments in Southeast Asia occur not to its liking. In fact this has already been indicated in the past when the PRC took some military measures to enforce its claim to the South China Sea islands.

The recent development in China has also brought into focus the future of Hong Kong and "relations" with Taiwan. Whatever hope existed until recently for a possibility of "one China two systems" now seems to have dashed away. As a corollary to this, it would seem that the PRC for some years to come would also be busy arranging its relations with Hong Kong and Taiwan. Taking into account the very intensive and extensive economic and financial relations between Southeast Asia, particularly the ASEAN countries, with Hong Kong and Taiwan, the way and manner the PRC arranges these relations would almost certainly affect the PRC's role in Southeast Asia as well.

In view of the above, it would seem that the future role of the PRC in Southeast Asia would depend to a great extent on its ability to develop mutually fruitful economic relations with the region, on its continued willingness not to press on the ideological platform and on its sound policy regarding the overseas Chinese. The future of the PRC's role is less certain compared to the future of the Soviet Union's role in view of the fact that the present Chinese leaders are much older than the Soviet and partly because of the recent development in China which could make it more introvert than some time ago.

Japan

Japan continues to make enormous economic progress. While its capacity to promote economic and trade relations with Southeast Asia is increasing, trade frictions with its allies continue to be a problem. The Southeast Asian countries are also looking for more access to the Japanese markets and financial resources. In this context, the prospect for future economic relations between Japan and Southeast Asia is also very promising.

The increasing economic power of Japan also brings with it the possibility of increasing political and military roles of Japan, especially since the United States continues to pursue the policy of defence burden sharing with Japan. While Japan continues to persist in its view that the self defence build-up is only for defensive purposes, some concerns in Southeast Asia have not been thoroughly abated, partly because of historical past, and partly because the "small" amount the Japanese pay for its defence build-up, namely a little more than one per cent of its GNP, is not so small if compared to the Southeast Asian budget. The one per cent defence expenditure of Japan amounted to more than 32 billion US dollars, which is more than the current Indonesia's total budget.

The problem of Japanese defence build-up, as far as Southeast Asia is concerned, basically results from the fact that a major Japanese life-line passes through the Southeast Asian waters. Therefore, the question persists as to the possibility of the Japanese taking military measures in order to protect those life-lines should this course of action become really necessary. The Japanese argument that the defence build-up is essential in

order to face up to the Soviet challenge from the North is not always taken or understood at its face value by many in Southeast Asia: (1) because of the possibility of Japan-Soviet rapprochement; (2) because the build-up includes blue water naval capabilities; (3) because the 1,000 mile defence "capability" is also projected southward from Japan.

The recent development in Japan, namely the present difficulties faced by the LDP and the progress made by the Japan Socialist Party (JSP), may have created long term concerns over the Japanese role in Southeast Asia. The possibility increases if one takes into account the possibility of the decreasing role of the United States in the years ahead in Southeast Asia. It is hoped, nevertheless, that the changes, if any, would not undermine the positive relations so far existing between Japan and ASEAN and its member countries.

It is clear that Japan should continue to play increasing and positive role in economic and trade relations with Southeast Asia. Yet the possibility for Japan to play an increasing political and security roles should be closely discussed and coordinated with the views of the Southeast Asian countries, especially those of ASEAN.

The United States of America

The Bush Administration seems to have difficulties in catching its breath in order to cope with the numerous initiatives of the Soviet Union, including in the Asia Pacific region. The United States, while continuing to be a very strong power politically, militarily and economically, also continues to face domestic problems and adjustments. The United States twin deficits remain a major

problem which affects its foreign policy outlook.

The United States has always been perceived by ASEAN as a major partner in economic development. In fact, some of the ASEAN countries perceive the US role in Southeast Asia as a stabilising factor. The Indochinese countries, while continuing to have difficulties in developing relations with the US, have nevertheless indicated their willingness to seek normalisation with that country. While there are many economic factors that should encourage the promotion of relations between ASEAN countries and the United States, there are also a few areas that may cause some problems in the future. The protectionist tendency in the United States is one of them. The reluctance of the United States to support the ZOPFAN/SEANWFZ concepts is another. The United States attitude on the Law of the Sea continues to cause some irritation at least in some countries in Southeast Asia.

For many years in the past, the United States regarded the PRC as the major threat to the region. Many countries in Southeast Asia followed the United States arguments on this matter. Then, the United States regarded the PRC as an important ally and in a way persuaded the Southeast Asian and other Asia-Pacific countries that the threat to the region was no longer the PRC but the Soviet Union. Many countries in the region were also taken in by this changing perception. Now in view of the US-Soviet rapprochement, it is no longer that clear who the culprit is in the eyes of the US.

In fact, many begin to question why and what roles US military might should play in Southeast Asia under such uncertain situation. Indeed, one may perceive a situation

where the US political and military interest in the region is or may be declining. While the US political and military roles in Southeast Asia may now become questionable, however, on the whole, the prospect of the United States playing a more positive and constructive role in Southeast Asia continues to exist, especially in economic and social developments.

Other Powers

While the roles of the four major powers are dominant in the Southeast Asian landscape, the roles of the other powers should not be neglected. Australia and New Zealand to the South and South Korea to the North as well as India to the West could also play positive roles in the economic development of the region. The increasing power of India in the sub-continent and in the Indian Ocean may draw attention in the future as to its impact on the stability of Southeast Asia in general.

In addition, some potential areas of conflict in Southeast Asia may continue to pose political and security problems for the region. The developments in the South China Sea should be carefully observed and monitored so that the area does not become a new hot-bed of conflicts in the region.

Finally, France and the United Kingdom, although to a less and declining degree, continue to play a role in Southeast Asia. The recent French initiative to help seek the solution of the Kampuchean problem is an indication of its continued interest in the region. The United Kingdom also, through its participation in the Five-Power Defence Arrangement, continues to maintain some interest in the region.

In short, it appears that the major powers certainly be welcomed by the South-east Asian countries to play major roles in the economic and social developments of the region. But their roles in political and military areas are less anticipated. There are differing perceptions among the countries of Southeast Asia on this matter.

ZOPFAN

The ASEAN countries have been promoting the idea of ZOPFAN (Zone of Peace, Freedom and Neutrality) in Southeast Asia since 1971. Many meetings have been devoted by ASEAN officials to the study of the matter. Some progress has been made with regard to the concept as well as the understanding among the ASEAN member countries. Some discrepancies of view, however, still persist. The ASEAN countries have agreed that ZOPFAN is a desirable objective and that initial efforts should be exerted towards its realisation. They have also agreed that the establishment of SEANWFZ (Southeast Asia Nuclear Weapons Free Zone) would be an important component of ZOPFAN.

While some countries have indicated support for the SEANWFZ concept, including the Soviet Union, the PRC and the Indochinese countries, other powers have indicated reluctance to support it, such as the United States. Japan's position is dubious: taking account of its anti-nuclear policy domestically, one would expect that Japan would at least be sympathetic to SEANWFZ; yet taking into account Japan's dependence on the United States nuclear umbrella, it may also be sympathetic to the United States position on the concept.

It is equally true with Australia and New Zealand. While they are parties to the Nuclear Free Zone in the South Pacific, thus they should be sympathetic to the SEANWFZ concept, they also seem reluctant to express support, perhaps in view of their ties with the United States. Both of course argue that it is for the states of Southeast Asia to decide whether they want to establish ZOPFAN/SEANWFZ or not.

The position of other powers, such as the United Kingdom and France, are not clear cut either. While the French objection to the concept may be more discernible in view of its continued nuclear testing policy in the South Pacific, the UK position is less easy to discern.

The discrepancies of view with regard to SEANWFZ among ASEAN countries seem to be on the timing of its establishment and the timing to approach the non-ASEAN powers for their acceptance. There is a view that as long as the Kampuchean question is not solved, the establishment of SEANWFZ would be untimely because it might be construed as "unilateral relinquishment" on the part of ASEAN, thus placing it at a disadvantageous position vis-à-vis other countries in the region. This argument is, to my mind, weak in view of the fact that the SEANWFZ is designed to include all Southeast Asian countries and that the Indochinese countries have supported the concept.

Another view relates to the United States attitude. It is that as long as the United States does not support SEANWFZ, then the concept would not be of much use or value. Again this argument is weak since the establishment of the Zone should be decided first and foremost by the regional countries rather than by non-regional powers.

Although the idea of SEANWFZ has surfaced since 1971, it has come to prominence after the adoption of the Law of the Sea Convention in 1982 and after the establishment of a Nuclear Free Zone in the South Pacific. In fact, the United States' fear that the SEANWFZ would undermine its global deterrent power is no longer very credible. The United States has adopted, for instance, the Tlatelolco Treaty denuclearising Latin America. The Nuclear Free Zone in the South Pacific as well as the concept being advanced for Southeast Asia would permit the passage of nuclear weapons in accordance with the regime of passage in the Law of the Sea Convention.

Although the United States objects to the Law of the Sea Convention (LOSC 1982) due to its provisions on deep seabed mining, the United States has in fact accepted the regime of passage in the LOSC. While the issue of port-calls of nuclear-powered ships or ships carrying nuclear weapons may not be clearly regulated in the LOSC, it is already accepted that it shall be left to the discretion of the states concerned. Even the Philippines, in whose territories the United States has bases or facilities, has passed legislation barring nuclear weapons from its territory, and this is independently pursued from the SEANWFZ concept. This indicates that the idea of ZOPFAN/SEANWFZ has wide support in the region.

The relevant question is therefore what would be the roles of ZOPFAN and SEANWFZ in Southeast Asia. To my mind the concepts would play a positive role in creating and maintaining stability in the region. If the region is declared a Zone of Peace, with Nuclear Weapons Free Zone as its component part, hopefully the region would and could at least be insulated from

becoming a target in a possible nuclear war. Furthermore, it will reduce the possibility of nuclear arms race in the region and therefore help to promote arms control and denuclearisation worldwide.

It is also hoped that the concept would enable the Southeast Asian countries to concentrate on their economic development and therefore strengthen the basis for national and regional resilience. The presence of major powers in the region are welcomed but only in a manner that would help promote economic development of the region. It is hoped also that the establishment of ZOPFAN and SEANWFZ would promote the denuclearisation of the Indian sub-continent and China, the two neighbouring regions of Southeast Asia with potentials for nuclear weapons. In short, the acceptance of ZOPFAN/SEANWFZ would create a favourable political climate in Southeast Asia, especially during the current era of East-West rapprochement and regional dialogue for mutual accommodation and cooperation.

Indochina and Southeast Asia

Recent developments in Indochina have roused some hope for positive changes. The economic imperatives seem to have helped modify Vietnam's policy on Kampuchea. Vietnam is no longer talking about the "irreversible" situation in Kampuchea, but is now willing to seek a "comprehensive political solution" to the problem. Vietnam has attempted to mend its relations with the PRC, the United States and Thailand. Domestically, the influence of reform is also growing.

Similar situation can also be found in Laos. In Kampuchea itself, the warring fac-

tions have met to try to seek solutions to their problems, either through the Jakarta Informal Meeting format or the Paris Conference. While the solution of the Kampuchean question would not be easy, there is already an air of dialogue between the warring factions in Kampuchea and between ASEAN and the Indochinese countries. This is certainly a positive development.

There have also been significant developments within ASEAN, which has been growing stronger politically and economically. The Kampuchean question has helped to weld ASEAN solidarity and cohesiveness, and at the same time ASEAN has been able to check the so-called further expansion of Vietnam and communism in Southeast Asia. ASEAN has also been able to strengthen economic and social cooperation among its members, although some of us may like to see ASEAN moving faster in this direction.

While some differences may continue to persist between ASEAN member countries, ASEAN has been able either to solve them quietly or place them under the rug. It is understood that the maintenance of ASEAN solidarity and cohesion is generally preferable to the pursuit of the differences. It is therefore clear that ASEAN has been playing a positive role in maintaining and promoting peace, stability and cooperation in the region.

There is no reason to assume why ASEAN should not continue in this role. I feel that it is equally in the interest of the non-ASEAN countries, particularly the Indochinese countries, to work together with ASEAN in this endeavour. Equally it would be in the interest of the non-regional powers to pursue this line and to support ASEAN's efforts in its quest for peace, stability, cooperation and progress in Southeast Asia.

The relations between ASEAN and Indochina would not be without problems in the future. As indicated above, the future of the South China Sea would have to be carefully considered and monitored. Some elements of conflict exist in the Sea. The South China Sea is bordered by non-communist ASEAN and the communist Indochina. In the Sea, there are various territorial and jurisdictional conflicts involving ASEAN states, Vietnam, Kampuchea and non-Southeast states such as the PRC and Taiwan. The Sea is rich in natural resources, living and non-living, which are important to the economy of the region. The Sea also has sea lanes which are important to maritime powers, particularly Japan, the United States, the Soviet Union and the PRC.

We also find military bases and facilities, namely Danang and Cam Ranh Bay in Vietnam and Clark and Subic Bay in the Philippines, accommodating rival major powers. The Sea, being an important route for all kinds of vessels and the site of many of offshore oil and gas exploration and exploitation, is also becoming more and more sensitive environmentally and ecologically. In short, the ASEAN and the Indochinese countries would have to pay more attention to the South China Sea and devise ways and means to prevent it from becoming a new hot-bed of conflicts in the region and as fast possible to turn it into an area of peace, stability and progress through cooperation and development.

Conclusion

There is at the moment a growing tendency towards "economism" in international relations and the decline of "ideologism." This seems equally true for Southeast Asia.

The emphasis on economic development opens up new possibilities for cooperation in the region, either between ASEAN and Indochina or between the ASEAN states and the major powers, particularly in the economic and social fields.

The major powers would continue to play a role in Southeast Asia, but their political and military roles would be less pronounced than their roles in the economic field, at least in some parts of Southeast Asia. The more Southeast Asian states are able to develop cooperation among themselves, the less the political and military roles of the non-regional powers would be necessary.

The acceptance of ZOPFAN and SEANWFZ concepts would promote peace and cooperation in Southeast Asia without necessarily affecting substantially the interests of the non-regional powers. In fact, it would be in the interest of the non-regional powers as well to promote ZOPFAN/

SEANWFZ in the region.

Southeast Asia now seems ready for co-operation. The era of confrontation, either between and among Southeast Asian countries or between Southeast Asia and the non-regional powers seems to be waning. This is a positive development that should be encouraged.

Yet some dangers are looming on the horizon, particularly the various conflicts that may arise in the South China Sea. Countries in the region, as well as non-regional powers, should work together to prevent the South China Sea from becoming a new hot-bed of conflicts in Southeast Asia. Equally, the increasing powers, especially naval powers, of Japan, China and India as well as the existing presence of the Soviet and the United States bases in the region, need to be continuously monitored so that they will not upset the prospect for the development of stability, progress and cooperation in Southeast Asia.

Pacific Island Economies: Structure and Current Developments

Te'o I.J. FAIRBAIRN

Chief Characteristics

THE TWENTY TWO countries of the South Pacific are dispersed over the Pacific Ocean, over an area of over 30 million km². The region's limits are set by the Northern Mariana Islands in the north-west, French Polynesia and Pitcairn Island to the east, Tonga and New Caledonia to the south and Palau to the west. Of the geographic area covered by the region, less than two per cent is land (see Table 1). Papua New Guinea, with a land area of 462,840 km², represents 83 per cent of the region's land area, followed by Solomon Islands with an area of 28,520 km². The remaining island countries are small to very small with four, Tokelau, Tuvalu, Pitcairn Island and Nauru each being only a mere 30 km² or less.

Although several of the Pacific Island countries are relatively compact (Niue and

Western Samoa, for example), many comprise numerous islands dispersed over vast areas of ocean -- Kiribati, French Polynesia and the Federated States of Micronesia -- and this excessive degree of dispersion poses severe development problems resulting from difficulties with administration, transportation and market fragmentation. Culturally, the region divides onto three groups, i.e. Melanesia, Polynesia and Micronesia, with Melanesia being the most populous and resource rich of the three.

The population of the region is currently just under six million, of which Papua New Guinea accounts for 61 per cent. Population densities differ widely and are particularly high for the small island countries. Population growth is among the highest in the world, at an average of 1.9 per cent per year and reflects high birth rates and unusually low mortality rates resulting, among other things, in high dependency ratios. Among the Polynesian countries, especially those with close ties to New Zealand, several show low or negative, actual population growth

Paper presented at the ASEAN-Pacific Islands Conference, Bali, 16-17 October 1989, sponsored by CSIS and East West Center.

rates due to heavy and sustained migration, with the result that more Niueans, Tokelauans and Cook Islanders live abroad than on their home islands.

Typologically, Pacific Island countries fall into four categories based on resource endowment, which in turn largely determines their capacity for self-sustained growth: The first category are the relatively large countries (Papua New Guinea, Fiji, Solomon Islands, New Caledonia and Vanuatu) having the best resource potential, accounting for 84 per cent of population, possessing extensive areas for agriculture, and in general, control large EEZs. These countries have achieved a relatively high measure of economic diversification (forestry, agriculture, fisheries, tourism and for some minerals) and economic growth as a direct consequence.

The second are the middle level countries of Western Samoa and Tonga with a modest resource base, limited land for agriculture, small EEZs, no exploitable minerals, and tourism potential which is limited. Hence prospects for significant economic diversification and growth are somewhat circumscribed.

The third are the remote resource poor countries of Kiribati, Tuvalu, Niue, Tokelau and the Cook Islands, which generally face severe poverty of land-based resources and a lack of capacity to exploit their comparatively large EEZs. Agriculture is predominantly subsistence and offer little scope for diversification.

The last group are those whose "special" advantages compensate for poor economic prospects. These include Nauru, which is overwhelmingly dependent on phosphate; Palau, Guam and the Commonwealth of the

Northern Marianas, all of which are strategically valuable to, and receive large financial grants from, the United States; and American Samoa whose favourable location and good harbour have allowed it to become a major fish processing centre. This group have been able to achieve living standards that are among the highest in the region.

Regional co-operation is well developed in the South Pacific and regional organizations provide a forum for political, economic, social and cultural co-operation. These regional efforts, largely effected through the South Pacific Forum and the South Pacific Commission and their specialized agencies, bring direct tangible benefits to participating countries, and tight economic or political integration is not pursued. Links have also been established with traditional donors for purposes of securing financial and technical assistance and on a per capita basis, the region is among the highest aid recipient in the world. While trading channels with traditional partners are well established (Australia and New Zealand primarily) economic relations with the Asia-Pacific rim have to date been limited.

Development Constraints

As can be seen from above, the Pacific Island countries are beset with geographic constraints, but economic and socio-cultural factors also serve to frustrate the realization of development aspirations. These constraints are particularly severe in the case of the smaller island countries whose future prospects for development are bleak.

The most obvious and the most far reaching constraint, affecting all countries with the possible exception of Papua New

Guinea, is their small physical size and remoteness from metropolitan centres. Compounding their small size, many island countries have a narrow resource base and the coral-based island such as Niue and Tokelau are virtually "resourceless rocks," lacking even arable land, forests, pastures, streams or rivers.

Not only are the countries of the region small, but many are themselves widely scattered, separated from each other and the major metropolitan centres by vast areas of ocean. The consequences of this isolation are high transportation costs, infrequent air and shipping services, often non-existent in the case of outer islands, and high administration costs.

Natural disasters such as hurricanes, floods, tidal waves and drought besiege many island countries as a result of their geography. Fiji, Tonga, Guam and the Northern Marianas are particularly vulnerable to hurricanes which destroy vital agricultural-based resources as well as housing and other facilities. The coral atolls are subject to tidal wave damage and if the predictions associated with the "greenhouse effect" are born out,¹ several of these atolls will cease to exist, and other countries will lose vast areas of shoreline which support the bulk of the population and supply vital sources of food and agricultural land.

Another consequence of smallness in terms of population, is that domestic markets are tiny by world standards and even in the case of Papua New Guinea with a population of 3.7 million, fragmentation and poor transportation effectively reduce

market size. Small and dispersed populations with low national incomes limit the potential for industrial diversification and restrict benefits of economies of scale. Small economies are also exposed to the vagaries of world market forces, being price takers for their agricultural exports, and sharp fluctuations in short-term world prices have an immediate effect on the local economy, especially the rural sectors. Heavy dependence on imported goods and services make the countries vulnerable to imported inflation and this has a tendency to negate domestic efforts to achieve price stability. Foreign aid and investment are also dominated by outside influences and since many island countries are heavily dependent on these sources, they add a further instability to development efforts.

Shortages of basic factor inputs, particularly development capital and skilled labour further, hamper development efforts. Low per capita incomes and poorly developed savings habits result in low domestic savings and underdeveloped capital markets which further increase dependence on foreign aid and investment. Shortages of skilled manpower extend to technical, professional, managerial, administrative and entrepreneurial levels and are a result of poor education and training in the past, and loss of skills through emigration. This "skills gap" has partly been filled by the recruitment of expatriates but this is a short-term solution, costly and not an altogether satisfactory alternative.

In general, the severe shortages of skills experienced by most of the Island countries weaken their capacity to absorb and apply modern technology and undermine the growth potential of all sectors, particularly the private sector which should be the most

¹P. Roy and J. Connell, "The Greenhouse Effect: Where Have All the Islands Gone?" *Pacific Island Monthly*, April/May 1989.

dynamic in terms of development efforts. In addition, cultural traditions are still powerful forces in contemporary Pacific Island society and the existence of certain cultural institutions tends to weaken the modernization process and slow the development effort, e.g. customary land tenure; attitudes to savings and the requirements of a capitalistic-individualistic-oriented economy; and efforts to reduce high population growth rates which run counter to strong religious and cultural beliefs.

Economic Structures

The striking variation in endowment between the relatively large and resource rich countries such as Papua New Guinea, and those such as Kiribati and Tuvalu which are small and resource poor, is reflected in their economic situation. The economies of the majority of the Pacific Island countries are dominated by the primary sector -- agriculture, forestry and fisheries -- on both a commercial and subsistence levels. As much as 60 per cent of the population are dependent on the primary sector and it typically accounts for over half gross domestic product. This is true of the Cook Islands, Solomon Islands, Tonga, Vanuatu, Western Samoa and Papua New Guinea. In sharp contrast to these countries are the United States associated countries (the Northern Mariana, Guam etc. and even American Samoa) where agricultural activity of any kinds is virtually non-existent due to rapid monetization, unsuitable agricultural conditions, or simply neglect, as has happened in Nauru. In Solomon Islands, Papua New Guinea, Tonga and Western Samoa, subsistence production is particularly strong, accounting for 25-30 per cent of gross domestic product and supplying foodstuffs, housing and basic

needs as well as a safeguard against the instabilities of the monetary economy.

The agricultural sector is hampered on the export side, due to problems of storage, transportation, lack of research to improve production and strains, lack of market analysis and poor incentives to farmers to improve crop output and quality of their produce. Another obstacle to enlarging export incomes from agricultural products is that the countries tend to produce a small range of common products and so compete with one another for markets. Forestry sectors are quite well developed in some countries, e.g. in Papua New Guinea forest products accounted for 12 per cent of export earnings in 1985² and Solomon Islands, Fiji, Tonga, Vanuatu and Western Samoa also have forestry industries, but in general there is little value-added processing of timber.

Several of the countries have substantial mining sectors. Papua New Guinea operates two of the largest mining companies in the world (Panguna Copper Mine on Bougainville Island and Ok Tedi Gold and copper mine in Mount Fabilan), and gold, silver and copper exports accounted for \$1,023 million or 69 per cent of total export earnings in 1988.³ New Caledonia has the second largest nickel reserves next to Cuba, and together with non-ferrous metals this accounts for virtually 100 per cent of the country's exports. Nauru is wholly dependent of phosphate production, to the exclusion of almost everything else. Fiji and Solomon Islands also have some mining interest, predominantly gold. In those countries with a sub-

²Commonwealth of Australia, *Australia's Relations with the South Pacific*, Joint Committee on Foreign Affairs, Defence and Trade (Canberra: Australian Government Publishing Service, 1989).

³*Quarterly Economic Bulletin* (Port Moresby: Bank of Papua New Guinea), December 1988.

stantial mining interest, export earnings are dominated by one or a few products and as there exert a substantial influence on the economy this may not altogether be so favourable.

Fiji, Papua New Guinea and New Caledonia have the most diversified industrial sectors characterized by several major processed products and import-substitute goods. Fiji's main industrial products (sugar, fish, coconut oil, concrete, cigarettes, beer, timber, wood products, biscuits, corrugated iron roofing) and manufacturing related to them account for 12 per cent of gross domestic product. In Papua New Guinea industrial activity is dominated by processing -- sugar, palm oil, wood products -- and import replacement manufactures. Tonga's Small Business Centre now produces a variety of manufactured products for domestic and export markets and American Samoa has substantial fish processing operations. For the remaining countries, however, except for the smallest who have virtually no manufacturing potential, the general pattern is one or two processing ventures together with a small range of import substitute enterprises.

The service sector is unusually large in most Pacific Island countries. Government administration, finance, tourism and trading are particularly important in the resource poor islands and may account for 60 per cent of gross domestic product. This high percentage is caused by a government sector inflated by foreign aid, high levels of remittance from overseas as is the case of Western Samoa, philatelic services (Western Samoa, Cook Islands), tourism and international finance centres. These "service" or "transfer" economies are found in the Cook Islands, Tuvalu, Niue and Tokelau and it is these aspects -- migration, remittances, aid

and bureaucracy -- which provide the impetus for development and for raising the level of welfare services.

Tourism is one of the major foreign exchange earners for Fiji and Vanuatu and is becoming increasingly important in Western Samoa, Tonga and Solomon Islands. For the micro-states, tourism has yet to make any impact due to their remoteness, water supply and accommodation problems.

Foreign private capital has played a vital role in many of the island countries to compensate for a paucity of both capital and expertise common throughout the region, as mentioned above. One consequence has been foreign domination of trading, mining, telecommunications, banking, insurance and hotels but the trend now is towards natural resource development. Papua New Guinea's mineral and petroleum exploration, and mineral exploration in Solomon Islands and Fiji are examples.

National Income

By the standards of developing countries, national income per capita is high in the Pacific region, ranging from a low of \$400 for Solomon Islands to a high of \$9,090 for Nauru (see Table 1), with an average for the region of \$1,297. The countries with higher than average gross domestic product per capita have had the benefit of special factors and/or extra financial aid, including substantial budgetary assistance: American Samoa benefits from large scale fish processing and personal remittances from overseas; Guam from a large military presence and tourism; New Caledonia from nickel production and highly paid expatriates including military; French Polynesia from tourism and a large military presence; and Nauru from phosphate mining.

Table 1

SOUTH PACIFIC ISLAND COUNTRIES: BASIC INDICATORS

Country	Popula- tion (000)	Land- Area (Km ²)	Sea- Area (000 Km ²)	Density People Per (Km ²)	GNP Per Capita (\$)	ODA Per Capita 1986 (\$)	Total Aid (\$m) 1986
American Samoa	37	199	390	185	5,280	1,250 ^a	(46.2)
Cook Islands	17	240	1,830	71	1,360	1,553	26.4
Federated States of Micronesia	86	701	2,978	123	1,301	893 ^b	(76.8)
Fiji	741	18,272	1,290	41	1,501	59	42.5
French Polynesia	186	3,265	5,030	57	7,849	1,376	247.6
Guam	120	541	240	222	4,860	-	-
Kiribati	68	690	3,550	98	480	203	13.4
Marshall Islands	41	180	2,131	226	1,303	-	-
Nauru	9	21	320	424	9,090	13	0.1
New Caledonia	154	9,103	1,740	8	5,760	1,387	206.6
Niue	3	259	390	10	1,080	1,400	4.2
Northern Mariana Islands	21	471	1,823	45	-	-	-
Palau	14	494	629	28	-	-	-
Papua New Guinea	3,650	462,840	3,120	8	730	73	263.6
Pitcairn Island	(100)	5	800	(20)	-	-	-
Solomon Islands	312	28,530	1,340	11	420	106	30.2
Tokelau	2	10	290	200	560	1,000	2.0
Tonga	100	699	700	143	720	139	15.1
Tuvalu	8	26	900	326	453	550	4.4
Vanuatu	155	11,880	680	13	530	171	24.4
Wallis and Futuna	14	255	300	55	750	620 ^b	(8.6)
Western Samoa	178	1,935	120	61	680	142	23.3
Unallocated	-	-	-	-	-	4	23.3
Total/Average	5,916	551,616	30,569	11	(1,297)	(178)	(1,058.7)

Notes: ^a1980^b1984

GNP Figure for FSM, apply to the Trust Territory of the Pacific Islands.

Aid flows note: in 1982 aid flows (mostly budgetary assistance) to U.S. associated Pacific Islands totalled \$520 million, and to Wallis and Futuna \$6 million.

Sources: *Pacific Economic Bulletin* (ANU), vol. 3, no. 2 (December 1989); *The Pacific Islands and the Asia-Pacific Community* (Honolulu, International Relations Programme, RS1 of EWC, forth coming); *Central Bank of Western Samoa Bulletin*, 1982; Commonwealth of Australia, *Australia's Relations with the South Pacific*, Joint Committee on Foreign Affairs (Canberra: Australia Government Publishing Service, 1989).

On the other hand, Fiji has achieved a higher than average income per capita (at least up to 1987 and the military coup) due to a sustained and diversified growth pattern, led by tourism, manufacturing and heavy foreign investment. The countries at the low end of the scale, Kiribati, Tokelau, Tuvalu and Western Samoa, would suffer even lower levels of income without the effects of heavy inflows of foreign aid and remittances. Of these countries, Kiribati is somewhat less disadvantaged as it receives substantial revenues (up to \$6 million per year) from an overseas investment fund (the Revenue Equalization Reserve Fund - RERF), accumulated from phosphate surpluses.

Data on growth rates in terms of real gross domestic product is not available for many countries, but by and large Fiji, Papua New Guinea, Solomon Islands and Tonga show a fairly consistent pattern of growth from the mid-1970s to 1985, although the recession of 1981-1982 affected most countries adversely. For the period 1972-1985, the annual percentage growth rates in real gross domestic product were 4 for Fiji, 1.7 for Papua New Guinea and 7.5 for Tonga.⁴ The rates imply a real increase in income per capita, except in the cases of Papua New Guinea and New Caledonia, which both experience negative changes, -1.1 and -0.3 respectively.⁵ For Kiribati the World Bank estimate is -12.6 per cent⁶ but this largely reflects the end of Ocean Island phosphate mining in 1979 and does not reflect changes in the living standards in Kiribati. Available evidence would indicate that the Cook Islands has also experienced a sizeable de-

cline during the 1970s and the other island countries would also have been affected by the decline, up to 1986, in prices for major exports such as copra.

Foreign Trade

Because of the relatively underdeveloped nature of Pacific Island economies, exports are fairly limited and natural resources dominate -- nickel, gold, copper, phosphate and other metallic ferrous ores and non-ferrous metals -- accounting for \$1,050 million in 1986. Other important export items (see Table 2) were agricultural based products -- sugar, oil, coconut oil, fruit and vegetables, cocoa and coffee, copra -- which accounted for \$449 million, followed by fish products valued at \$234 million and logs and timber worth \$142 million.

Papua New Guinea, Fiji and Solomon Islands have the most diversified export sectors with at least five major export items each. Among the smaller islands, exports are dominated by copra and coconut products and other agricultural products. For Nauru, American Samoa and New Caledonia a single product is of overwhelming importance, phosphate, nickel and fish canning respectively.

Major trading partners are the European Community Countries, United States, Australia and New Zealand -- a pattern resulting from political and historical associations as well as geography and transportation considerations. There are many examples of heavy export flows to one or two metropolitan centres which reflect these ties -- American Samoa to the United States, Cook Islands to New Zealand and French Polynesia to France. The same is true of imports as can be seen by the pattern of flow

⁴Commonwealth, *Australia's Relations*.

⁵Ibid.

⁶Ibid.

from France to New Caledonia, Australia to Papua New Guinea and New Zealand to the Cook Islands.

Export performance has not been encouraging on a whole and combined with low commodity prices on international markets, has caused serious balance of payments problems. In some cases, personal re-

mittances and foreign aid have offset commodity account deficits but not to a sufficient extent to reduce the balance of payments pressure. Corrective measures have had to be implemented such as devaluation and foreign exchange control with subsequent contraction in economic activity. Although prices have recovered lately, a stable balance of payments is still elusive.

Table 2

SOUTH PACIFIC ECONOMIES: EXPORTS BY VALUE AND PRINCIPAL PRODUCTS, 1986

Country	Total Exports (\$ Million)	Principal Products
American Samoa	177 ^a	Canned fish and other fish products
Cook Islands	3 ^b	Fruit, clothing, copra, pearl shells
Federated States of Micronesia	...	Copra
Fiji	281 ^c	Sugar, gold, coconut oil, molasses
French Polynesia	35 ^d	Coconut oil, shells, fruit
Guam	39 ^d	Transhipped goods
Kiribati	4	Copra, fish
Nauru	116 ^a	Phosphate
New Caledonia	184 ^d	Nickel ore, non-ferrous metals
Niue	(0.40) ^d	Coconut products, fruit juice, copra
Northern Mariana Islands	4 ^b	Vegetables
Palau	...	Copra
Papua New Guinea	1,484 ^e	Gold, copper concentrates, coffee, forest products, cocoa
Solomon Islands	70	Copra, canned fish products, timber, palm oil, cocoa
Tokelau	..	Copra, handicrafts
Tonga	6 ^e	Coconut oil, bananas, desiccated coconut, vanilla
Tuvalu	(0.70) ^c	Copra, handicrafts, stamps
Vanuatu	14	Copra, fish re-exports, beef, cocoa, beans
Wallis and Futuna	...	Trochus
Western Samoa	15 ^e	Taro and <i>ta'amu</i> , coconut oil, cocoa, logs

Sources: Australian National University (1988), Asian Development Bank (1987), South Pacific Commission (1985), Carter (1984), Bank of Papua New Guinea (1988). Exports from Marshall Islands are not known; those from Pitcairn Island are negligible.

Notes: ... not available

^a1982-1983

^b1985

^c1987

^d1983

^e1988

Foreign Aid

The South Pacific is one of the most heavily assisted regions in the world, with an estimated \$1,059 million (1986) or \$178 per capita flowing into the region by way of official development assistance, both multi-lateral and bilateral (see Table 1). This aid plays a crucial role in meeting government budgetary and development needs and in providing foreign exchange.

About 90 per cent of official aid is bilateral with Australia, France, the United States and is mainly in the form of budgetary assistance to former colonies or dependent territories. This is particularly true of France and the United States whereas Australia, New Zealand and the United Kingdom aid tends to be more diversified.

Multilateral aid is dominated by EC (under LOME), UNDP and international financial institutions such as ADB and the World Bank. This form of aid is generally accorded to members, and soft-term concessional loans and technical assistance are predominant forms of aid offered by some agencies.

French Polynesia, New Caledonia, Papua New Guinea and the United States associated Pacific Islands are the main aid recipients and until recently this was mainly budgetary aid. On a per capita basis, the small countries are heavy recipients -- Cook Islands, Niue, Tokelau and Wallis and Futuna (see Table 1).

ODA accounts for 40 per cent and over of total government revenue and between 35 and 50 per cent of total government expenditure in most countries and this heavy dependence is becoming a source of concern because it weakens self-reliance, leads to ar-

tificially high consumption patterns and distorts resource use not to mention the possibility of external political pressure. However, without such assistance development programmes could not be carried out, so support for foreign aid continues. It appears that many of the traditional aid donors are scaling up assistance and are willing to make long-term commitments, the proposed United States government aid arrangement with Palau being an example. New sources are also opening up e.g. Japan, and it would appear, therefore, that aid dependency will remain high in the foreseeable future.

Development Strategies

Formal development plans are prepared by nearly all Pacific Island countries as a guide to determining development directions and mobilizing resources. By and large, they are elaborate statements of government public works programmes and are for either five or three year terms. Because of the varying nature of the economies, the plans vary in nature and scope but they all contain certain common elements -- goals shared by all Pacific Island government in their quest for better living standards for their people: the paramount objective is to raise the quality of life by effectively utilizing available natural resources to promote economic growth and development and achieve greater national self reliance; to increase production using available natural resource -- agricultural, fishery and mineral where these are available; to ensure a wide participation in the economic development process, and economic justice through a fair distribution of the benefits of economic growth; to safeguard the environment through prudent management of natural resources and the

adoption of processes which will not damage the local and global environment; and to preserve cultural integrity by maintaining a balance between development and vital traditional values and customs.

It should be noted that the small coral atolls are a special problem in that they have few if any natural resources on which to base economic development. Their goals involve identifying special economic opportunities which may enable them to raise living standards and the welfare of their people. Some of these "special" avenues are: maritime employment overseas, philatelic services, establishing trust funds and exploring ways of developing, and reaping the benefits of their often large EEZs.

In order to promote these goals, key strategies are highlighted in most development plans and certain key areas present opportunities for economic growth and development. These areas are:

Agriculture: This is of overriding importance in all development plans with the exception of the small coral atolls which lack resources for any but minimal agriculture. Expanding agricultural output by exploiting land resources more intensively is seen as a means of enlarging local food supplies reducing imports and increasing self-sufficiency, and strengthening exports. The larger countries -- Papua New Guinea, Solomon Islands and Fiji -- have the greatest scope for expanding agriculture and all have met with considerable success. The smaller countries continue to emphasize copra production, sometimes their only cash crop, and attempt to strengthen subsistence production. Heavy reliance on a few major export crops has its dangers, namely low commodity prices which undermine production incentives on the one hand, and failure to replace

aging trees, small land areas poor managements, vulnerability to natural disasters, land tenure systems which hamper expansion, on the other.

Fisheries: Fishing for local consumption continues to be of great importance. It is generally small-scale and restricted to coastal waters which in some cases have limited potential. Export fisheries, mainly for tuna, use large-scale capital intensive techniques and concentrate on pelagic waters, and it is here that the major potential exists, especially for those islands with extensive EEZs.

Japan, the Philippines, South Korea, Taiwan and the United States are active in the Pacific harvesting tuna. The annual catch is 100,000 tons which, unprocessed, is worth \$55 million⁷ and almost 80 per cent of this is processed locally, mainly by American Samoa. Fiji and Solomon Islands also have established shore-based tuna processing facilities.

Many Island countries benefit from licensing fees paid for access to EEZs, but they only render about 5 per cent of the value of the catch. Pacific Island countries need to further develop commercial fishing and processing activities to better benefit from this extensive natural resource. Regional agencies -- Forum Fisheries Agency (FFA) and the South Pacific Commission (SPC) -- have both played vital roles in the financial, economic and research fields to help established the potential for tuna in the region. The FFA is currently negotiating with Japan to produce a multilateral fisheries treaty similar to the one between the United States and 16 Pacific countries, which allows

⁷*The Pacific Islands and the Asia-Pacific Community* (Honolulu: International Relations Programme, RSI of EWC, forthcoming).

island members to benefit from the United States fishing in their EEZs. Both these treaties act as a basis for facilitating management of fisheries resources and a means by which island countries may gain a fairer share and greater financial gain from this resource.

Forestry: Forestry products, mainly logs but also timber, plywood and woodchip, account for about one sixth of the region's total export earnings with Papua New Guinea and Solomon Islands being the dominant exporters. These two countries account for 4 per cent of the world's exports of non-coniferous saw and veneer logs. Most large-scale export orientated operations are owned by foreign co-operations, principally Japanese.

Fiji's past investment in pine growing is beginning to pay off and in time this industry will make a significant impact on exports and stimulate wood-based activities. Several other island countries have extensive forestry resources but so far only Western Samoa and Vanuatu have been able to export and as yet this is on a small scale. Unregulated logging is a danger, not only to the sustainability of forests as a natural resource but also on a wider scale-erosion, damage to catchments, silting of rivers and streams, to name a few and it is imperative that any future logging ventures be accompanied by strict controls and careful management, initiated at the official level.

Minerals: As noted, the Melanesian islands are well endowed with minerals, but recent interest centres on the minerals potential, particularly gold, of the so-called "Rim of Fire" that includes Papua New Guinea, Vanuatu, Solomon Islands and Fiji within the Pacific region. The potential for this region is being explored and some of the

smaller islands could have significant possibilities. Natural gas and oil have been found in Papua New Guinea, copper in Fiji and Vanuatu, silver in Vanuatu, coal in Papua New Guinea, bauxite in Fiji and Solomon Islands and chromite sands in other island countries, but so far these have not reached the production stage.

Tourism: Most Pacific islands have a potential for a tourist industry and in many -- Fiji, French Polynesia, Guam, Northern Marianas -- it is already a key economic sector; in Western Samoa and the Cook Islands it is actively being developed. Tourism's value is well recognized -- as a foreign exchange earner and as a stimulus to activity in associated areas, e.g., construction and transport -- but some countries have deliberately limited the rate of tourist development recognizing its detrimental effects on the culture. There is scope for a major tourism expansion in the majority of Pacific island countries but transportation links and infrastructure need to be expanded and improved in many cases.

Industry: Pacific island countries have not been able to carry out industrialization to any great extent due to the handicaps of small domestic markets, capital and skill shortages, etc., and existing industrial development is dominated by a few export-oriented industries based on sugar, palm oil, fish and coconut oil and small manufactured products. Soft drinks, biscuits, concrete products, toilet paper, ice cream and confectionary are all widely available but are essentially import substitutes enjoying a natural advantage due to high transportation costs.

Several countries have established specialized industrial zones in an effort to promote small industries geared to both import replacement and export production. Tonga

has established a Small Industries Centre in which about 22 industries are already operational, the majority of which are either foreign owned or joint ventures. Fiji has Industrial Estate facilities and has recently established an Export Processing Zone. The latter facility has attracted considerable interest from foreign companies particularly Australia and New Zealand. Western Samoa is currently reviving its Export Processing Zone which, although legislated for in 1974, never came into operation. Western Samoa also operates an industrial estate since the early 1970s and it presently supports around 20 enterprises, and is in the process of establishing a Small Industries Centre similar to that operating in Tonga.

Most countries are actively seeking to stimulate industrialization by making available a range of industrial concessions including tax holidays, tariff protection and various forms of direct assistance. In addition, there are two schemes provided by the governments of Australia and New Zealand (The Pacific Islands Industrial Development Scheme - PIIDS) and the Joint Venture Scheme (JVS), respectively designed to foster economic development by assisting and encouraging joint venture schemes with local businessmen. Foreign investment up to now has been attracted to large-scale investment projects associated with mining and tourism but as Tonga's Small Industries Centre demonstrates, other enterprises can prove attractive to foreign investors.

Other Considerations: Off Shore banking facilities are available in Western Samoa, the Cook Islands and Vanuatu. These provide international bank facilities and tax havens for international companies and are a means of diversifying and expanding government revenue through payment of registration fees and related charges.

Several of the Pacific Island countries, e.g., Western Samoa and Fiji, have given emphasis to the role of the private sector in promoting economic development. The reason for this emphasis is a clear recognition of the dynamic nature of the private sector and its ability to provide more efficient resource allocation than the government sector has done in the past. It is not uncommon for government enterprises to incur heavy losses which are a drain on scarce resources. In order to foster the private sector several initiatives have been taken: a strengthening of financial incentives and concessions for private sector investment, including foreign investment, e.g., tax holidays as provided by Fiji's Export Processing Zone; privatization of government-owned assets as is happening in Fiji and Western Samoa; and government intervention in the economy has been relaxed in many cases to allow a greater play to market forces.

Growth Prospects

Although the capacity of Pacific Island countries to achieve sustainable growth is closely related to their resource endowment and presence of special factors, no firm predictions can be made because being such small economies, their development depends to a large extent on external forces -- international pricing, the continuation of foreign aid and investment, etc. Having noted this, however, two scenarios emerge. The first concerns the large resource rich countries of the region -- Papua New Guinea, Fiji, New Caledonia and Solomon Islands, which are the so-called "lucky countries." Given good management in the future these countries should be able to achieve long-term self-sustaining growth. Success depends largely upon favourable trading conditions and im-

proving existing knowledge about resource potential, mobilizing capital and technical expertise and erecting a congenial domestic environment for foreign investment.

The second scenario is the one for the smaller countries, especially the tiny coral atolls. These are the problems economies of the region, bedevilled by narrow resource bases, isolation, rigid land tenure systems, low savings and innovative capacities, etc. The resource base is simply too small for any self-sustained growth in the long term. Foreign aid, overseas migration and personal remittances will continue as options for countering the disadvantages but the social and economic costs remain high.

Other Leading Issues

The critical question for all Pacific Island countries is how to accelerate economic growth and foster development. The main issues have been dealt with above but there are other important aspects which have a bearing on development, some for individual countries, some for the region as a whole. Future discussions of development prospects must address these issues which are summarized below.

Population control has received little serious attention on a whole. It aims to reduce population growth to a level the economy can reasonably absorb and this needs to be done through a lowering of the birth rate. This is imperative in those countries where population densities are already high and emigration outlets are non-existent, if subsistence poverty is to be averted.

Subsistence revitalization is a vital complement to the monetary economy. In some countries this sector has all but vanished and apart from its role as a hedge against unstable external markets and reliance on

imported foodstuffs, it does hold development potential. Renewed efforts to promote adoption of appropriate technology aimed at increasing productivity, communication and transport are called for as well as a careful look at present land tenure systems which very often inhibit the most productive utilization of land and associated resources.

Greenhouse effect, as mentioned before, presents an alarming prospect for many Pacific Island countries, particularly the small atolls: Kiribati, the Marshall Islands, Tokelau and Tuvalu will cease to contain any habitable land if the sea level rises by 1 metre or more.⁸ For other islands a Greenhouse-induced sea level rise means inundation and erosion of coasts and for most of these countries expensive engineering works to provide protective measures would hardly be an option.

The special problems of the smaller countries: Even without the impending doom of the Greenhouse effect, the countries mentioned above face the problems of fast growing populations which pose increasing pressures on a very limited resource base, including limited employment opportunities. Migration is not a new concept in the Pacific and in Tokelau for example, "it is already well established. ...some of every group of siblings must emigrate simply because the local resources are seen as insufficient".⁹ Migration to the United States from the Marshall Islands is a possibility but for Tuvalu and Kiribati there is little opportunity to migrate. Permanent international migration is viewed as a key solution by many, and the Jackson Report, 1985,¹⁰ acknowledged the exceptional problems facing these

⁸Roy and Connel, "Greenhouse Effect."

⁹Ibid.

¹⁰Commonwealth, *Australia's Relations*.

countries and suggested that migration should be considered as an adjunct to aid programmes such as now operate between Australia, Kiribati and Tuvalu.

Asia-Pacific Community: Pacific Island countries need to participate more actively in Asia-Pacific affairs as to date they have had minimal involvement in wider regional initiatives such as ASEAN and PECC. Close co-operation can offer trade, aid and training opportunities for the South Pacific as well as to help project the special interest of the region on a larger stage.

Fisheries: The Fisheries Access Treaty between the United States and Pacific countries, and the possibility of a similar treaty with Japan have already been mentioned but since many Island countries control comparatively large EEZs, fishing and associated marine and aquaculture activities must reap greater benefits than they are currently doing. One issue that must also be addressed is the question of gill-netting; the Japanese have already undertaken to reduce this by 60 per cent but it must go much further. This is an extremely damaging fishing practice not only to island fishing resources but also to the whole marine ecosystem.

Regional co-operation has been an important facet of Pacific Islands' development and many initiatives concerning trade,

infrastructure and fisheries are already in place. However, co-operation now needs to extend into more difficult areas such as development finance, industrial planning, tourism and civil aviation. The special problems of the small countries could also be given greater emphasis in regional initiatives.

Conclusion

Pacific Island countries face many problems of development, yet several have made notable progress in the fields of agriculture, mining and the service industries. The capacity to achieve sustainable growth is best for the larger countries where a wide range of resources provides many development options. The challenge for the future here is to put in place policies which will mobilize financial, human and technical resources needed for further development.

The problem countries of the region are those smaller island countries whose paucity of natural resources dictates "no growth" scenarios. These countries will continue to be dependent on overseas aid, migration, and co-operative arrangements with development organizations within the Asia-Pacific region. The plight of these small countries is a challenge both to governments and to regional and international co-operation.

Book Reviews

Every Government Needs Golkar

Military Ascendancy and Political Culture: A Study of Indonesia's Golkar by Leo Suryadinata. Ohio: Ohio University Center for International Studies, Southeast Asia Series no. 85, 1989, 223 pp. This review article written by Onghokham translated from *Tempo*, 18 November 1989.

INSPITE OF the term political culture as contained in the title of this book, it is in fact a study of Golkar (*Golongan Karya* - the Functional Group). Amongst political scholars, such as Leo Suryadinata, educated in the United States, there is indeed an emphasis on the aspect of the society's culture in their approach or method used. This differs from those who put emphasis on the problem of class interest, and even class conflict.

Suryadinata in his cultural approach uses the society's classification of Java into the Abangan, Priayi and Santri groups of Clifford Geertz. According to Suryadinata,

although this classification of Abangan, Priayi and Santri is limited to the society in Java, it can also be applied to the other regions.

Suryadinata thinks that Golkar is dominated by the political culture of the Abangan and Priayis, who in the daily language of Indonesia are termed as *Islam KTP* (Muslim in I.D. Card only - i.e. nominal). Golkar is seen as being close to the Armed Forces leadership, most of whom have the Priayi-Abangan culture. The leadership of Golkar, such as the late Ali Moertopo, comes from that stratum of society. During the Soekarno period this was represented by PNI and PKI. Suryadinata also hints that Golkar is very active in disseminating and consolidating the Pancasila ideology. For him, this constitute another evidence that Golkar represents the political culture of the Abangan and Priayis. Here however, there are two conflicting points. If Suryadinata is presumably right, and I think that many are in accord, what we see however is that at every general election, Golkar's seats as DPR (House of Represen-

tatives) and MPR (People's Consultative Assembly) are increasing, which means winning the general election. On the other hand, we see Islamisation of Indonesia's society which Suryadinata sees it with the increase of the number of Mosques, other places of moslem worship at luxurious hotels or the increasing member of people performing the Muslim fast.

The question which arises is that if the number of KTP Muslims is so big in Indonesia's society, is it still relevant if we continue to call the Indonesian society being 90 per cent Islam. Or from the pattern of voting in the General Election of 1955 up till now we should call the Islam a minority rather than majority, at least politically? What is the interest of Islam in politics, for instance in the field of international relations, economic development, state budget and finance?

Suryadinata does not draw any conclusion from this. It is a pity that although this work begins with the political culture of the Indonesian society, it is not further elaborated. This work does concentrate too much on Golkar as a political organisation, the general election, factions within Golkar, problems relating to Golkar with Islamic parties in Indonesia. In the last part Suryadinata poses several questions which are also often raised here without giving any clear answers to them. Can Golkar become an autonomous organisation being detached from the Armed Forces and from the national political leadership, especially in the future after the leadership's generational change?

If it is true that Golkar is indeed the realisation of the Abangan-Priayi political

culture, it is certain that they will have a future. However, Suryadinata sees a change in the religion of Java. The new trend is Islamisation.

According to Suryadinata Golkar is adjusting to that trend, in the sense that it is approaching Islam, or is inclined to adjust itself to follow this Islamisation. The Abangan-Priayi political culture can more flexibly adjust itself with the new cultural trend. How far this is true remains to be seen.

There are those who compare Golkar with the Revolutionary Institutionalisation Party in Mexico, which although calling itself revolutionary is in fact a conservative party in power which has enjoyed the full support of the government for tens of years. Suryadinata also sees the Golkar as being similar to the Revolutionary Party in Mexico. He also compares it with the Liberal Democratic Party in Japan, and the Congress Party in India. Ultimately, Suryadinata contended, whatever will be Golkar's fate, every government needs Golkar which has in fact had its roots already during the Soekarno period.

In my view Leo Suryadinata's approach through societal political culture is not quite accurate. More relevant with the era of the "floating mass" at this juncture would be the approach of the elite political culture. Every political organisation and political system will develop and it is the sensitivity to these changes that will very much determine the fate of Indonesia's political future. The classification into Abangan, Priayi and Santri is becoming irrelevant in judging and evaluating political developments in Indonesia.

Islamic Banking

Islamic Banking in Southeast Asia edited by Mohamed Ariff. Singapore: ISEAS, 1988. This review article is written by Mohsin S. Khan (IMF, Assistant Director, Research).

FOR those who associate Islamic economics and banking exclusively with the Arab countries in the Middle East, Iran, and Pakistan, this collection of papers will probably come as somewhat of a surprise. But it really shouldn't. Several countries in Southeast Asia are Muslim -- with Indonesia being the largest Muslim country in the world -- and others have sizeable Muslim minorities. As such, it is only natural that the practice of Islamic banking that has grown enormously in the past two decades would be evident in these countries in some form as well. This book represents the thinking on, and the experience with, Islamic banking in the Southeast Asian region.

The concept of Islamic banking stems from the absolute prohibition of interest (*riba*) contained in the Qur'an. All banking and financial transactions in an Islamic economy must therefore be conducted without interest, and Islam suggests ways and means by which interest and the economic institutions that accompany it can be implemented. It is the no-interest feature that distinguishes Islamic banks from their traditional, or Western, counterparts.

This volume contains an introduction by the editor and eight papers. Among these eight papers is a historical survey on Muslims in Southeast Asia, a general paper on Islamic

banking, four country studies (Malaysia, Philippines, Indonesia, and Thailand), and a paper on the Islamic Development Bank in Jeddah. The concluding chapter contains a useful summary discussion of Islamic banking from the Southeast Asian perspective by Mohamed Ariff. These eight papers will be discussed in turn in this review.

The paper by Omar Farouk (Chapter 2) is divided into a historical background and a contemporary profile. Islam was brought to Southeast Asia by Arab traders and not by military conquerors; conversion to Islam was, therefore, voluntary on the part of the local populations. The Muslims lost out to the colonialists -- the British, Dutch, Portuguese, and Spaniards -- in terms of power, although with the influx of Muslim Indians into the region, their numbers rose. At present, about 90 per cent of Indonesia's population (of 175 million) is Muslim. In Malaysia, with a much smaller percentage of Muslims (about 55 per cent) in the total population, Islam plays a much more prominent role in politics. The phenomenon of Islamic revivalism in the 1980s in Malaysia has been quite striking. Brunei also has a Muslim majority, and as the official religion Islam receives state patronage. In the other countries in Southeast Asia -- the Philippines, Thailand, Burma, and Singapore -- Muslims have been a minority and have had little impact on the politics at the national level, although they do play a significant role at the local level in certain instances. Farouk's paper is good background reading to the analysis of Islamic banking in the region because it provides a nice perspective on Islam and Muslims in Southeast Asia.

Nejatullah Siddiqi's paper (Chapter 3) on the theory and practice of Islamic banking lays out most of the relevant issues, although it is a bit dated by now. The discussion on alternative modes of financial intermediation that banks can utilize if debt-financing is excluded is quite comprehensive and useful. The first best are *Mudarabah* and *Musharakah* transactions, which are essentially variants of profit-sharing arrangements. The second best arrangements include leasing, mark-up, hire purchase, etc. In fact, Islam permits a wide freedom of contracts, assuming that the terms of the contract are not in violation of the rules of Islamic law (the *Shariah*), and this flexibility makes possible a virtually open-ended menu of financial transactions and instruments. It is surprising that Siddiqi does not mention this possibility; the list that he gives is only partial. There are some other points where one can differ with Siddiqi. For example, I do not subscribe to the assertion that the central bank can engage in fixing "certain profit-sharing ratios or prescribing a range within which they are allowed to vary" (p. 41). In my view the central bank *cannot* interfere with the freedom of individuals to negotiate the terms of any contract, and thus cannot set profit-sharing ratios. But these comments do not detract from the overall usefulness of the paper, and the Appendix on Islamic financial institutions around the world will be valuable not only to scholars, but I imagine to bankers and policymakers as well.

The four country studies can be divided into two groups: the first where Islamic banking exists in some form, i.e., Malaysia and the Philippines; and the second, where it does not, i.e. Indonesia and Thailand. In Chapter 4 Zakariya Man provides an infor-

mative account of the foundation and development of the Bank Islam Malaysia Berhad (BIMB). The interesting feature of the BIMB is that it has been quite successful in both the mobilization of deposits and in terms of profits while competing directly with conventional banks in Malaysia. Government support has certainly helped, but that has not been the only thing. After all, governments provide support to all banks, and there is no evidence in Zakariya Man's paper that suggests that BIMB has been favoured at the expense of other banks. As discussed by Michael Mastura in Chapter 5, the Philippines Amanah Bank (PAB), being an official specialized institution, has obviously had more direct government support. In a sense one can view the PAB as a regional development bank aimed at assisting a particular segment of the population. Its success, therefore, cannot be measured solely by standard economic criteria, no more say can the operations of an agricultural development bank or an export bank. Such institutions are in the business of subsidizing certain economic activities, and are thus dependent on government transfers to perform their functions. While the PAB engages in conventional interest-based financial transactions as well, there is a presumption that eventually these will be eliminated.

Islamic banking has not taken hold in Indonesia (Chapter 6 by M. Dawam Rahardjo) or Thailand (Chapter 7 by Surin Pitsuwan), although various informal community-based institutions, such as credit cooperatives, do exist. The absence of a formal Islamic bank in Thailand is not too surprising given that Muslims are a small minority in that country. The case of Indonesia is more interesting and M. Dawam Rahardjo provides an explanation of why there has been no concerted

attempt to implement an Islamic bank. Part of this has to do with the nature of the state, and a deliberate attempt by the government to keep Islam out of politics and economics. Perhaps equally important was the role of the scholar-statesman Mohammad Hatta, a Muslim economist who argued for a distinction between *riba* and interest. The former was associated by Hatta with usury, allowing him to conclude that "low" interest rates were permitted. This type of distinction has been rejected by contemporary Islamic scholars and economists, but the legacy of Hatta continues to impact on banking activity in Indonesia. But Indonesia should not be singled out as being unusual since there are many Muslim countries that do not have Islamic banks -- Iraq, Libya, Morocco, and Syria are examples.

The paper by M.A. Mannan on the Islamic Development Bank (Chapter 8) seems an outline in a volume on Southeast Asia. The discussion is interesting but has little to do with Southeast Asia, and one has to wonder why it was included. Reading it as an independent piece, however, one does get picture of the activities of the IDB. The most important information one obtains from this paper is that the IDB has not been particularly successful in *mudarabah* transactions, relying instead on what M. Ariff calls "second-line techniques" of leasing, installments, and mark-up (particularly in its foreign trade financing operations). If an international institution like the IDB has been unable to achieve the most desirable form of operations, it is no wonder that progress by banks in individual countries in this direction has been slow and cautious.

Mohamed Ariff in his overview (Chapter 10) presents an excellent summary of the contents of the volume and the implications

that derive from the analyses. What is missing, however, is a serious effort to examine why Islamic banks have relied to such an extent on "weakly Islamic" modes of financing that have resulted in an excessively short-term asset concentration. This is a generalized problem existing in Islamic banks over the world, including those in Iran and Pakistan, as well as in the Islamic Development Bank. Is this due to risk aversion, to government policies, to lack of expertise, or all of these? Will this pattern change in the future? Certainly one can expect that over time experience and the build-up of human capital will reduce the reluctance of Islamic banks to venture more and more into true profit-sharing arrangements on the lending side. The present situation can thus be viewed as a transition from an interest-based system to an Islamic system. Of course, economists can help speed up the transition and the papers in this volume can lead to solutions to the problems of Islamic banks. For example, one could think of forming a portfolio of good-performing firms as an asset that could substitute for *murabaha*. Shares in this portfolio could be made available to commercial banks and the public. The Amana Mutual Fund established in the United States in 1984, for example, would be one model. This type of mutual fund could be privately sponsored, although there is nothing to preclude governments from putting a portfolio of shares in firms together.

Islamic banking, despite the doubts of many Muslims and non-Muslims alike, has continued to grow. This volume of papers is a useful addition to the Islamic banking literature, and it will undoubtedly have an influence on the thinking on the subject in Southeast Asia as well as in the rest of Muslim world.

Foreign Investment in Indonesia

Foreign Investment and Government Policy in the Third World: Forging Common Interests in Indonesia and Beyond by Robert B. Dickie and Thomas A. Layman. Hampshire: Macmillan Press, 1988, 240 pp. This review article is written by Dr. Thee Kian Wie, Centre for Economic and Development Studies, Indonesian Institute of Sciences (PEP-LIPI).

DICKIE'S and Layman's book is an interesting study of the various policies which the Indonesian government has pursued in regard to foreign investment in the various sectors of the economy, specifically in the financial and extractive sectors, including the oil, mining, and forestry industries. Unlike most other studies on foreign investment in Indonesia, this study does not cover in detail the various policy problems related to foreign investment in the manufacturing sector. The merit of this book therefore lies in its detailed analysis of the policy problems related to foreign investment in precisely those sectors and subsectors which hitherto have not been studied as extensively as the manufacturing sector, particularly the financial sector and the mining industries.

Dickie's and Layman's study originated in a project sponsored by the Ford Foundation as early as 1978 to study the capital market in Indonesia, in particular the newly re-opened Jakarta Stock Exchange. As such, this study has focused more on those policy

issues related to the development of a capital market in Indonesia, in particular the equity sharing policies. On a more general level, this book is mainly concerned with the Indonesian government's policies in attracting as well as regulating foreign investment in the financial and extractive sectors. By comparing the implications and effects of these policies with similar policies pursued in other developing countries, Dickie and Layman have been able to highlight the relative merits and demerits of the various policies in these areas.

While most developing countries, including Indonesia, have generally welcomed foreign direct investment, they have at the same time also tried to regulate the activities of multinational corporations (MNCs) with a view to steering the activities of these MNCs in a direction more in accordance with the perceived national interest. In fact, while Indonesia's New Order government initially took quite a liberal stance with regard to foreign direct investment, since the mid 1970s it has increasingly tightened the controls on foreign investment in line with a general increase in regulation over and direct intervention in the economy. Dickie and Layman argue that the speed with which the Indonesian government has regulated and intervened in the foreign investment process has been conditioned both by domestic political forces and by the extent to which its economic strength has permitted it to strengthen its bargaining position. Indonesia, therefore, has not been in a position to take as hard a line towards foreign investment as Mexico until the end of the oil boom in 1982,

because Mexico's much larger oil reserves gave it a stronger bargaining position vis-à-vis the MNCs and their home country governments. After the end of the oil boom era in 1982, however, both Mexico and Indonesia were forced to relax the stringent control on foreign investment.

While the erstwhile fears of most developing countries of the power of multinational corporations have in recent years abated, their concern about the loss of "national economic autonomy," if MNCs are given free rein in their operations, has not. This concern is not unique to developing countries, as many developed countries too display considerable concern about their loss of economic sovereignty if foreign investment is not subjected to some degree of control and regulation. The increasing concern, even dismay in the US about the rapid rise of Japanese direct investment in America is only the latest example of a universal concern over a "foreign over-presence" which is not limited to developing countries alone. However, as developing countries have shed their erstwhile phobia of MNCs, most of them have now come to regard these MNCs from a less ideological and more pragmatic perspective. This shift in perspective has led to a corresponding shift in policies vis-à-vis the MNCs.

Although most MNCs are now more aware of and sensitive to the concerns of developing countries, and therefore more willing to adjust their operations in accordance with the policies and conditions in developing countries, there is no doubt that MNCs will always have to contend with the one basic long-term determinant affecting foreign investment in any country, namely, the force of *economic nationalism*. While

economic nationalism is, as argued earlier, not unique to developing countries, it is stronger in the developing countries, the bulk of which achieved statehood only a few decades ago.

In his study on the ideology of economic nationalism, the late Professor Harry Johnson argued that from the point of view of its effects on economic and political behaviour, nationalism attaches great value to having *property* owned by nationals and having *economic functions* performed by nationals. In particular, nationalism attaches great value to property and functions which are deemed important to the identity and power of the nation.¹ More generally, this imparts a strong tendency for the economic policy of these new nations to have, as a major national objective, the establishment of an economy similar to those of nations that are regarded as powerful, and to have that economy controlled by nationals.

Johnson further argued that there are two aspects to this objective. Firstly, where the national objective lacks productive facilities that are considered important to the power of powerful nations, national policy aims at establishing such facilities at all costs and *under national control*. This in turn means a preference for public ownership as a way of ensuring national control as well as antagonism towards foreign investment, and a determination to either prevent, *control*, or *restrict and regulate foreign investment* (emphasis added). These two preferences actually involve some self-contradictions, at least from the viewpoint of economists mainly in-

¹Harry G. Johnson, "The Ideology of Economic Policy in the New States," in *Chicago Essays in Economic Development* ed. David Wall (Chicago: University of Chicago Press, 1972), p. 26.

terested in economic efficiency.² These efficiency-minded economists might argue that antagonism towards foreign investment would hamper efforts to obtain scarce inputs, such as capital, entrepreneurship, technology, and organisational expertise, required to develop the country's resources. However, more nationalist-minded economists would argue that the social costs of a considerable degree of foreign control over the country's resources would outweigh the social benefits of a faster rate of economic growth.

Secondly, where there are productive facilities which are not controlled by nationals, there is often a tendency to take control over them. These attempts may include confiscation, nationalisation, or *restrictive government regulations*. These regulations might include strict guidelines regarding *domestic participation* in or *control* over the *ownership of foreign enterprises* and their *management* (emphasis added).³

Obviously, these regulations involve discriminatory measures in favour of nationals in general and, in certain cases, in favour of certain groups of nationals. In other words, the discrimination is often not homogeneous.⁴

Discriminatory measures in favour of nationals is hardly a phenomenon limited to young, developing countries, and one could certainly argue that Harry Johnson's analysis applies with equal validity to advanced, industrial countries. However, it is true that in plural societies, such as Indonesia and Malaysia, certain discrimina-

tory measures are taken in favour of certain categories of nationals, specifically the "indigenous" citizens, to redress certain historic "imbalances."

Johnson's analysis of the importance of economic nationalism in influencing economic policies of young, developing nations does go a long way in explaining the increasing restrictiveness of Indonesia's foreign investment policies, as described in detail in Dickie's and Layman's book, and already foreseen almost two decades ago by Professor Sadli, the first chairman of Indonesia's capital investment board, when he stated that economic nationalism might be growing more flexible and less doctrinaire, but that its basic aspirations of doing the job of nation-building oneself remained alive and powerful.⁵ However, in our view economic nationalism is not the sole explanatory factor determining the direction of a developing country's foreign investment policies. There is, in addition, the phenomenon of what Raymond Vernon, professor emeritus of the Harvard Business School, has called the "*obsolescing bargain*." This is the phenomenon in which the host country over time is re-assessing the original bargain with the foreign investor(s), and pushes for a re-negotiation of its original terms.⁶

This reassessment is generally caused by a shift in the perceptions of the host coun-

⁵M. Sadli, "Foreign Investment in Developing Countries: Indonesia," in *Direct Investment in Asia and the Pacific* ed. Peter Drysdale (Canberra: Australian National University Press, 1972), p. 202.

⁶Raymond Vernon: "Conflict and Resolution between Foreign Direct Investors and Less Developed Countries," in: *The Multinational Enterprise in Transition - Selected Readings and Essays* eds. A. Kapoor and Phillip D. Grub (Princeton: Darwin Press 1972), pp. 392-94.

²Johnson, "Ideology of Economic Policy," p. 26.

³Ibid., pp. 26-27.

⁴Ibid., p. 27.

tries regarding the role and importance of foreign direct investment. As time goes by, the advantages that a developing country sees in any foreign investment project tend to decline. This development is hardly surprising, as the most valuable and obvious infusion of capital, technology, managerial skill, and information generally takes place at the start of a project. After the early transfer of these elements of the foreign investment package, the value of these foreign inputs tends to decline in the view of host governments. In part this change in perception of the value of the foreign inputs is caused by the emergence and enhanced capabilities of national entrepreneurs, in terms of both capital and managerial capabilities. In addition, this change in perception is also affected by the enhanced capability of the host government itself in negotiating with the foreign investors about the terms of entry for the foreign investor.⁷

It can be expected that with their increased self-confidence, these national entrepreneurs would tend to exert pressure on their government to restrict the scope of activities of foreign investors whom they increasingly see as obstacles to their own advancement. This pressure tends to be particularly strong with foreign investment projects where the general nature of the project has largely remained unchanged over the years. Under such circumstances, the foreign investment project may look increasingly less useful to the host country, and the host country may then be quite amenable to reconsider the original bargain with the foreign investor, and start pushing the latter for a new bargain more favourable to the

host country (hence the term "obsolescing bargain").⁸

Indonesia's evolution of policies towards foreign investment in the financial and extractive sectors is described clearly in Dickie's and Layman's book. They point out that even though the New Order government since 1967 has welcomed foreign investment, it has endeavoured to steer these investments towards the achievement of specific national goals. While economic nationalism has clearly been the major determinant of Indonesia's foreign investment policies, the "obsolescing bargain" has also been at work in the various successive measures which the Indonesian government has taken with regard to foreign investment, particularly in the extractive sector. In the oil and mining industries the trend towards increased control and restrictions and less favourable treatments of foreign investment was reflected in the successive government negotiations with foreign investors on prices, royalties, share contracts, and taxes on the resource rents realised from the natural resource-based industries. In the oil sector the "obsolescing bargain" was reflected in the renegotiation of the terms on foreign investment in this sector which evolved from concession agreements to contracts of work and then to production sharing agreements. Over time production sharing agreements have also been changed as oil companies were no longer allowed to keep up to 40 per cent of the total oil production to recover their costs, but were subsequently required to amortise their costs over a seven-year period (applicable to fields having a long projected life).

⁷Peter McCawley, personal communication to the author.

⁸Vernon: "Conflict and Resolution," pp. 392-94.

In the case of the mining projects the Indonesian government attempts to increase the domestic or national returns from these projects resulted in the replacement of "first generation" contracts with the more restrictive "second" and "third generation" contracts. In the forestry sector, too, the terms for foreign investors have also become more restrictive over time, particularly since 1975 when new timber developments were closed to foreign investors and existing joint venture firms were required to reach majority (at least 51 per cent) local ownership by 1985. Only in the financial sector has the "obsolescing bargain" not been as evident as in the other sectors, as the Indonesian government from the outset imposed stringent limitations on the number and geographical location of foreign branch banks in Indonesia. Moreover, given the concern of the Indonesian government that unrestrained expansion of the foreign banks' activities would constrain the growth of the weaker national private banks, no new foreign bank licenses were granted since 1969. This ban was only lifted on October 27 1988 when the government introduced a new package of measures, including banking reform measures allowing new foreign banks to be established in Jakarta as well as the opening of branches of these foreign banks in six other cities outside of Jakarta, provided that these branch offices extended at least 50 per cent of their loans to export-oriented activities.

The banking reform measures of October 1988 and the more liberal foreign investment policies introduced since May 1986 indicate that the direction of the obsolescing bargain can sometimes be reversed if the negotiating strength of the foreign firms increases re-

lative to the host country governments. This has certainly been the case with Indonesia since the end of the oil boom era in 1982 when the attendant slowdown in economic growth forced the Indonesian government to ease its restrictive foreign investment policies and dismantle the cumbersome regulatory framework which had until then hampered the operations and expansion of foreign investment projects.

The period covered in Dickie's and Layman's book ends in 1986, just before the series of deregulation measures in the field of trade industrial policy and foreign investment policy were being introduced. This, however, does not detract from the merit of this book in highlighting the trade-offs involved in the restrictive foreign investment policies increasingly pursued by the government since the mid 1970s, in particular as reflected in the equity-sharing policy. Despite some repetitiveness in their arguments, one would certainly agree with Dickie and Layman that an effective institutional and legal infrastructure are most important in reconciling the need for more foreign investment to speed up economic growth with the widespread felt need to retain and increase local autonomy in the national economy. Dickie's and Layman's book is a carefully researched study, particularly useful to policy-makers faced with the need to carefully assess the various aspects and implications of the various policy measures to increase national economic autonomy without deterring foreign investment from contributing foreign capital, advanced technologies, and modern managerial techniques to national development.

Contributors



- Hasjim DJALAL,
Head, Agency for Research and Development, Department of Foreign Affairs. He obtained his Ph.D on Foreign Affairs, University of Virginia (1961); he is former Indonesia's Ambassador to Canada (1983-1985) and Ambassador/Deputy Permanent Representative at the Indonesian Permanent Mission of the United Nations in New York (1981-1983).
- J. Soedjati DJIWANDONO,
Editor, *The Indonesian Quarterly*, and member of the Supervisory Board, CSIS. He obtained his Msc. and Ph.D on International Relations from London School of Economics and Political Science, University of London (1982).
- Te'o I.J. FAIRBAIRN,
Adjunct Research Associate, East-West Center.
- A. Hasnan HABIB,
Adviser to the Minister/Head of the Agency for Study and Technology Development for Strategic Industries; he is former Indonesia's ambassador to Thailand and concurrently the country's Standing Representative at ESCAP and is the former Ambassador to the US; graduated from the Military Academy in Yogyakarta (1945-1946) and War College Yugoslavia (1962-1964).
- Djisman S. SIMANDJUNTAK,
Executive Director, Institute of Management Prasetya Mulya (IMPM); member of the Board of Directors, CSIS. He graduated from Faculty of Economics and Social Sciences, University of Parahyangan in 1973 and obtained his Ph.D on Economics at the University of Cologne (1983).
- Jusuf WANANDI,
Chairman, Supervisory Board, CSIS; member Board of Governors, East West Center, Honolulu. He graduated from the Faculty of Law and Social Sciences, University of Indonesia (1960). In 1977 he was Congressional Fellow sponsored by the Political Science Association (APSA).

BUSINESS REPLY MAIL

**PLACE
STAMP
HERE**



**Centre for Strategic and International Studies
Jalan Tanah Abang III/23-27, Jakarta 10160 Indonesia**

Each paragraph describing each author's contribution should accompany the manuscript.

biographi-
sts, should

Address all correspondence, permission requests, and books for review to The Indonesian Quarterly, Jalan Tanah Abang III/23-27, Jakarta 10160, Phones: 356532-35, Telex: 45164 CENTRE IA, Cable: CSIS JAKARTA.

Inquires concerning subscription should be sent to NV Indoprom Company (Indonesia) Ltd., P.O. Box 2090 JKT, Jakarta, Phones: 8091928, 8091936, 8092574, 8092653. Subscription price is Rp 11.500,00; US\$35.00 for subscribers living outside Indonesia.

Orders for single back issues and bound volumes should be addressed to The Indonesian Quarterly, Jalan Tanah Abang III/23-27, Jakarta 10160, Phones: 356532-35.